S. HRG. 99-1026, PT. 1

# WHITE COLLAR CRIME

## HEARINGS

BEFORE THE

## COMMITTEE ON THE JUDICIARY
## UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

OVERSIGHT OF THE PROBLEM OF WHITE COLLAR CRIME

FEBRUARY 27 AND MARCH 11, 1986

**Serial No. J-99-89**

**PART 1**

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE

65-428 O WASHINGTON : 1987

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S521-34

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# CONTENTS

## STATEMENTS OF MEMBERS


| | Page |
|---|---|
| Kennedy, Hon. Edward M., a U.S. Senator from the State of Massachusetts | 1, 3 |
| Metzenbaum, Hon. Howard M., a U.S. Senator from the State of Ohio | 14 |
| Thurmond, Hon. Strom, a U.S. Senator from the State of South Carolina | 16, 99 |
| Biden, Hon. Joseph R., Jr., a U.S. Senator from the State of Delaware | 18, 100 |
| Grassley, Hon. Charles E., a U.S. Senator from the State of Iowa | 21 |
| Hatch, Hon. Orrin G., a U.S. Senator from the State of Utah | 23 |
| DeConcini, Hon. Dennis, a U.S. Senator from the State of Arizona | 23 |


## CHRONOLOGICAL LIST OF WITNESSES

### TUESDAY, FEBRUARY 27, 1986


| | |
|---|---|
| Jensen, D. Lowell, Deputy Attorney General, U.S. Department of Justice | 24 |


### TUESDAY, MARCH 11, 1986


| | |
|---|---|
| Statements of Stan Wheller, Yale Law School, New Haven, CT; Donald R. Cressey, University of California, Santa Barbara, CA; David Cherrington, Brigham Young University, Provo, UT; and Kenneth E. Carlson, ABT Associates, Cambridge, MA | 101 |


## ALPHABETICAL LISTING AND MATERIALS SUBMITTED


| | |
|---|---|
| Carlson, Kenneth E.: | |
| Testimony | 190 |
| Prepared statement | 195 |
| Appendix A | 202 |
| Cherrington, David: | |
| Testimony | 146 |
| Prepared statement | 162 |
| Cressey, Donald R.: | |
| Testimony | 111 |
| Prepared statement | 112 |
| Jensen, D. Lowell: | |
| Testimony | 24 |
| Prepared statement | 41 |
| Questions from Senator Charles E. Grassley | 22 |
| Letter from Senator Joseph R. Biden, Jr., with additional questions, March 11, 1986 | 95 |
| Wheller, Stan: Testimony | 101 |

# WHITE COLLAR CRIME—PART 1

THURSDAY, FEBRUARY 27, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The committee met, pursuant to notice, at 1:17 p.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senators Biden, Kennedy, Metzenbaum, Grassley, Specter, East, McConnell, and Hatch.

Staff present: Dennis W. Shedd, chief counsel and staff director; Diana L. Waterman, general counsel; and Cindy LeBow, minority chief counsel.

The CHAIRMAN. The committee will come to order.

I apologize that an emergency arose, and I could not be here exactly at 1 o'clock. I like to start hearings on time. Senator Kennedy has an urgent meeting and has to leave, and I am going to ask that he go ahead and make his statement.

## OPENING STATEMENT OF SENATE EDWARD M. KENNEDY

Senator KENNEDY. I thank the Chair and I ask that it appear after the chairman's statement and the Senator from Delaware, Senator Biden's statement in the record, and I will ask that the complete statement be included in the record as read.

I want to commend you, Mr. Chairman, and the Senator from Delaware, Senator Biden, for developing the sets of hearings and to thank our witnesses, their willingness to come and address an issue of very substantial importance and consequence. This issue is really not a strange one to the Judiciary Committee, the whole question of white-collar crime.

The best estimate is given for business fraud, about $160 billion a year is moving out of the pockets of consumers across this country and it is a matter which deserves both the attention of this committee and the attention of the Senate.

I want to point out to our members of the committee once again that this issue we visited in a very considerable period of time, the recodification of the Criminal Code some years ago. We had more than 75 hours of hearings, 20,000 pages of paper, and as I see the Justice Department here, they remember very well if they look back over my shoulder and see the very substantial box over there which is the collection of hearings and testimony from outstanding business men and women who are doing things right in our country and who provided us with guidance and also some paths which were important for us to be sensitive to. It also points out some of

the real challenging practices which have been readily acceptable in some very limited areas within the community which we ought to be willing to address, we got into some very considerable number of the areas which I know the series of hearings are going to address and the recodification, and I would hope that those who are following the activities of this committee would look to S. 1630 from the 97th Congress and S. 1722 from the 96th Congress, and S. 1437 from the 95th Congress.

A very significant amount of the course of the hearings that we had were focused on the white-collar crime issue and we made some important recommendations in sections 402 and 403 concerning liability of corporations and corporate agents, 1325, the tampering with physical evidence section, other sections which I have outlined in the course of my statement, on wreckless endangerment, monetary offenses, washing racketeering proceeds, failure to produce records, and in the Sentencing Act of 1984 with the provisions that were accepted we also deal in a related way to some of the areas that we ought to address in terms of white-collar crime.

I know that part of the course these hearings are going to be on the issues of Federal rules of evidence which we did not get into at all, and I will be looking forward to the results of those particular recommendations.

One thing, Mr. Chairman, that I mentioned is as we worked through this process in a bipartisan way with the recodification, one mechanism that we set up was contact with the business roundtable as well as the Chamber as well as with the Justice Department, and they worked very closely with the members of the committee and their staff and we were able to I think make some very substantial progress.

I still remember the time when Mr. Shapiro was here and spent about 6 hours and rolled up his sleeves with du Pont and went through this with the members of the committee and also the staff members and made a very important I think contribution, and I commend the testimony of Mr. Shapiro before this committee in 1979. I think it is very useful testimony.

I welcome the focus and attention that is given by the committee. I am grateful to the support of the Chair and particularly the leadership that is being provided by the Senator from Delaware, Senator Biden, who has spent a great deal of time on this issue and has spoken about it, is concerned about it and I think is offering very constructive leadership on it.

I thank the Chair and ask that my whole statement be included.

[The prepared statement of Senator Kennedy follows:]

STATEMENT OF SENATOR EDWARD KENNEDY
ON WHITE COLLAR CRIME
FEBRUARY 27, 1986

I WELCOME THE RETURN OF THE SENATE JUDICIARY COMMITTEE TO THE PERVASIVE PROBLEM OF WHITE COLLAR CRIME. WITH BUSINESS FRAUD ALONE ROBBING AN ESTIMATED $160 BILLION PER YEAR FROM THE POCKETS OF EVERY CITIZEN, THE IMPACT OF WHITE COLLAR CRIME IS RIVALING THE SIZE OF OUR RECORD-BREAKING BUDGET DEFICITS.

AS WE REOPEN THIS IMPORTANT SUBJECT TODAY IT IS WORTH REMEMBERING THAT DURING 15 YEARS OF DEBATE IN THE 1960'S AND 1970'S OVER THE NEED FOR A NEW FEDERAL CRIMINAL CODE, THE ISSUE OF COMBATTING WHITE COLLAR CRIME WAS REPEATEDLY EXAMINED. MR. CHAIRMAN, NOT ONLY YOU AND I, BUT OUR FORMER COLLEAGUES PHIL HART, ROMAN HRUSKA, CHAIRMAN MCCLELLAN AND MANY OTHERS WORKED THROUGH OVER 75 HOURS OF HEARINGS AT THE SUBCOMMITTEE AND FULL COMMITTEE LEVEL, AS WELL AS EFFORTS OVER FIVE YEARS ON THE SENATE FLOOR ON THIS SUBJECT -- AND THE RECORD THAT WE PRODUCED IS A GREAT RESOURCE FOR THE COMMITTEE.

WE HAVE SOME 20,000 PAGES OF TESTIMONY AND 16 VOLUMES OF HEARINGS AND REPORTS ON THE SUBJECT OF CRIMINAL CODE REFORM IN GENERAL, WHICH I HAVE PLACED ON THE TABLE BEFORE US. WHITE COLLAR CRIME OCCUPIES A LARGE PORTION OF THE DEBATE.

IN WORKING FOR SUCH LEGISLATION SINCE 1975, THIS COMMITTEE DEVELOPED SEVERAL SPECIFIC PROPOSALS IN THESE AREAS.

FOR <u>SUBSTANTIVE</u> PROPOSALS IT IS WORTH LOOKING AT THE OLD CRIMINAL CODE REPORTS TO S. 1630 FROM THE 97TH CONGRESS, S. 1722 FROM THE 96TH CONGRESS, AND S. 1437 FROM THE 95TH CONGRESS.(HOLD UP THREE VOLUMES).

SPECIFICALLY, LOOK AT:

-- SECTIONS 402 AND 403 (CONCERNING LIABILITY OF CORPORATIONS AND CORPORATE AGENTS).

-- SECTION 1325 (TAMPERING WITH PHYSICAL EVIDENCE).

-- SECTION 1617 (RECKLESS ENDANGERMENT).

-- SECTION 1762 (MONETARY OFFENSES).

-- SECTION 1803 (WASHING RACKETEERING PROCEEDS).

-- SECTION 1733 (FAILURE TO PRODUCE RECORDS).

AND AS YOU KNOW, TITLE IX OF THE 1984 CRIME CONTROL ACT SIGNIFICANTLY STRENGTHENED CURRENCY AND FOREIGN TRANSACTION REPORTING REQUIREMENTS.

MANY OF THE WHITE COLLAR REFORMS OF EXISTING PROCEDURE AND SANCTIONS THAT WE SOUGHT IN THE 1970'S WERE ALSO ENACTED INTO LAW. FOR EXAMPLE, THE NEW MONEY LAUNDERING LAW WILL MAKE IT EASIER FOR GOVERNMENT INVESTIGATORS TO PROBE THE SOURCE OF BULK CASH TRANSACTIONS WITH BANKS, AND THE NEW RESTITUTION AND FORFEITURE LAWS WERE PART OF LAST YEAR'S LANDMARK CRIME CONTROL ACT.

THE SENTENCING REFORM ACT OF 1984 WHICH I INTRODUCED OVER TEN YEARS AGO CONTAINS MAJOR CHANGES AIMED AT THE WHITE COLLAR CRIMINAL SO THAT A CRIMINAL PENALTY FOR CORPORATE CRIME IS NOT VIEWED IN THE BOARD ROOM AS MERELY "A COST OF DOING BUSINESS." THE REFORMS INCLUDE THE ELIMINATION OF PAROLE, THE INCREASE OF FINES, PROVIDING FOR INNOVATIVE FORMULAS FOR TYING FINE AMOUNTS TO THE GAIN DERIVED BY THE DEFENDANT OR THE LOSS SUFFERED BY THE VICTIM, AND NOTICE REQUIREMENTS TO INJURED CONSUMERS.

IN OUR CODE REFORM WORK WE LARGELY LEFT THE FEDERAL RULES OF EVIDENCE UNTOUCHED SO THIS IS AN AREA WHERE WE VENTURE INTO FRESH TERRITORY. I LOOK FORWARD TO LEARNING MORE ABOUT SENATOR BIDEN'S INTENTIONS REGARDING EVIDENTIARY CHANGES.

A CENTRAL THEME OF THESE HEARINGS SHOULD BE: WHAT IS A RESPONSIBLE POSITION FOR THE BUSINESS COMMUNITY ABOUT THE NEED TO CURTAIL THE WHITE COLLAR CRIMINAL. I UNDERSTAND WE WILL HEAR FROM SCHOLARS AND FROM CORPORATE EXECUTIVES REPRESENTING SOME OF OUR NATION'S BEST COMPANIES TO LEARN WHAT MANY BUSINESSES ARE DOING RIGHT.

BACK IN THE MID-1970'S THE BUSINESS ROUNDTABLE, THE U.S. CHAMBER OF COMMERCE, AND PARTICULARLY, THEN DUPOINT CHAIRMAN, IRVING SHAPIRO, WERE EXTREMELY HELPFUL TO THIS COMMITTEE. I CAN RECOMMEND MR. SHAPIRO'S 1979 STATEMENT BEFORE THIS COMMITTEE ON BEHALF OF THE BUSINESS ROUNDTABLE ON THE GENERAL PRINCIPLES FOR WHITE COLLAR CRIME LEGISLATION. THIS STATEMENT ARTICULATES THE CONSENSUS THAT HAD ALREADY BEEN REACHED, AND IT CAN MARK A STARTING POINT FOR THIS COMMITTEE AS WE BEGIN THIS NEW SET OF HEARINGS. I ASK THAT HIS STATEMENT BE REPRINTED IN THE RECORD OF THESE HEARINGS.

MAY I SUGGEST, MR. CHAIRMAN, THAT AN INQUIRY BE MADE ABOUT RECONSTITUTING THE BUSINESS GROUP THAT DEVELOPED THE CRIMINAL CODE PROVISIONS ON WHITE COLLAR CRIME. THE BUSINESS ROUNDTABLE, THE CHAMBER OF COMMERCE AND OTHER PAST PARTICIPANTS SHOULD BE CONTACTED.

WITH THESE SUBSTANTIAL RESOURCES AT OUR DISPOSAL, I LOOK FORWARD TO THE COMMITTEE'S VERY AMBITIOUS HEARINGS. AGAIN, I WELCOME THE RENEWED INTEREST IN WHITE COLLAR CRIME.

STATEMENT OF IRVING S. SHAPIRO, ON BEHALF OF THE BUSINESS ROUNDTABLE CONCERNING WORKING DRAFT OF AUGUST 24, 1979, OF PROPOSED BILL TO RECODIFY THE FEDERAL CRIMINAL LAWS

I.

Mr. Chairman and members of the subcommittee; I am pleased to appear before you on behalf of the Business Roundtable. My name is Irving S. Shapiro of Wilmington, Delaware. I am Chairman and Chief Executive Officer of E. I. DuPont de Nemours & Co., Inc. of Wilmington, Delaware. I am a member of the Bar of the States of Delaware and Minnesota and several federal courts. From 1943 to 1951 I was an attorney in the Criminal Division of the United States Department of Justice. I served as Chairman of the President's Search Committee for a new Director for the Federal Bureau of Investigation.

I am the past Chairman of The Business Roundtable ("Roundtable") and am a member of its Policy and Executive Committees.

The Roundtable is an association of business executives of 192 companies, practically all of which are publicly held. These executives examine selected public issues that affect the economy, develop positions on them which seek to reflect sound economic, social, and legal principles, and make these positions known to the public and its representatives in government. The Roundtable was founded in 1972 in the belief that business executives should take a role in the continuing debates on public policy. The Roundtable's headquarters are at 200 Park Avenue, New York, New York.

The Roundtable's views on particular issues are developed by Task Forces. The Corporate Organization Policy Task Force, of which Mr. Alden W. Clausen, President of Bank of America, is chairman, has overseen development of the Roundtable's position on the proposed criminal code. I have assisted that Task Force on this matter and testify at Mr. Clausen's request.

At the outset I compliment you, Chairman Drinan, the members of your Subcommittee,[1] your staff and the staff of the members for the work you have done in bringing this important piece of legislation to its present status. You determined to produce a bill. You and your Subcommittee members have devoted literally hundreds of Congressional hours to the task. The Working Draft[2] upon which I comment represents a long step towards sound legislation, and I am pleased to have this opportunity to comment on the work accomplished so far. May I also compliment Mr. Hutcheson, the Subcommittee's Chief Counsel and his colleagues, for their work with you and the Subcommittee members.

During the course of the 95th and 96th Congresses, the Roundtable submitted to the House Criminal Justice Subcommittee and Senate Judiciary Committee a series of Comments on various aspects of the proposed Federal Criminal Code embodied in S. 1437 and House counterpart bills. Those papers are dated respectively April 6, 1978; April 28, 1978; May 22, 1978; February 27, 1979; April 17, 1979; and April 24, 1979. I am submitting copies of these papers for the record in this hearing and will occasionally refer to them as "Roundtable Comments" with the appropriate date and page references.

II.

The Roundtable believes that from the Working Draft, emerge certain important principles which, it appears to us, are wisely governing the Subcommittee's codification effort.

First, the Subcommittee's Working Draft clarifies basic concepts of criminal law, particularly culpability and complicity, and in addition sets forth uniform definitions and certain rules of construction. These objectives were first enunciated in the Model Penal Code. They were fully supported in the Brown Commission Report. We think they are now well-applied in the Working Draft.

Thus, Section 301[3] defines four states of mind ("intentional," "knowing," "reckless," and "negligent") while Section 302 recognizes three elements ("conduct," "circumstances," and "results") to which a mental state must attach in every crime. We commend the Subcommittee for specifying states of mind for each of the three elements in most offenses throughout the Working Draft

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[1] Subcommittee on Criminal Justice of the Committee on Judiciary of the House of Representatives ("the Subcommittee").

[2] Working Draft of the Subcommittee on Criminal Justice, dated August 24, 1979 ("Working Draft").

[3] All section references will be the Working Draft unless otherwise specified.

and the Subcommittee's working rule of using a "knowing" instead of a "reckless" state of mind in most instances. The Roundtable believes that the wide use of a "knowing" state of mind is consistent with the existing state of the law and the fundamental proposition that criminality should involve "mens rea."

Chapter 5 of the Working Draft establishes reasonable rules governing complicity. Section 501(a)(1)(B) provides that an accomplice is one who "knowingly" commands, induces, procures or aids another in the commission of an offense "with intent that the offense be committed." The Roundtable accepts the well-established line of cases that "conscious avoidance" or "willful blindness" satisfies the requirements for a "knowing" state of mind. *Turner* v. *United States*, 396 U.S. 398 (1970); *United States* v. *Jewell*, 532 F. 2d 697 (9th Cir. 1976); *United States* v. *Jacobs*, 475 F. 2d 270 (2d Cir. 1973). *Accord* S. Rep. No. 605, 95th Cong., 1st Sess. 59 (1977).[4]

Section 502 clarifies the liability of an organization for the conduct of its agents, rendering them liable for offenses committed within the agent's actual, implied or apparent authority, where the agent intends to benefit the organization. Although this rule will render an organization criminally liable where an agent has acted contrary to company policy or even personal instructions, the Roundtable recognizes this as the existing law, *United States* v. *Cadillac Overall Supply Co.*, 568 F. 2d 1078 (5th Cir. 1978); *United States* v. *Hilton Hotel Corp.*, 467 F. 2d 1000 (9th Cir. 1972), cert. denied, 407 U.S. 1125 (1973), and supports the provision as an effective way to encourage diligent supervision of employee law compliance.

These and the other rules of complicity contained in Chapter 5 make it appropriate for the Subcommittee to have rejected the novel offenses of "reckless failure to supervise" and "omission to perform a duty," proposed in Sections 403 (c) and (b) respectively in S. 1437 of the 95th Congress, because of their vague and sweeping nature and because they might permit liability without consciousness of or participation in the wrong doing. See Jeffries and Stephan, "Defenses, Presumptions and Burden of Proof in the Criminal Law," 88 Yale L.J. 1325, 1371–76 (1979) on criminal liability without fault. The provisions of Chapter 5 governing complicity reach just about every conceivable case where an individual intends to have a significant role in wrongdings which occur within the organizational context.

Second, the Subcommittee has also limited itself to the codification of Title 18, leaving codification of non-Title 18 offenses for a later time. This is sound because many non-Title 18 offenses are in the regulatory area, and these present different problems in a number of ways:

(*a*) Most Title 18 crimes are recognized by society as evil or dangerous; accordingly, there is little likelihood of innocent transgression. Regulatory requirements on the other hand are not malum in se, but involve conduct which is illegal because it has been forbidden.

(*b*) Regulatory offenses are often complex, detailed, not easily understood. They are frequently described in less accessible rules, not statutes, and governed by little precedent, and hence the ambit of illegal conduct is difficult both to know and predict.

(*c*) A comprehensive regulatory system would involve greatly different conditions and requirements. General provisions intended to cover the gamut of different regulatory offenses would be a crude response to a subtle problem and would not reflect the many differences involved.

For these reasons the Roundtable believes that the penal provisions not presently contained in Title 18 should be separately examined after enactment of the proposed criminal code. That separate examination should consider:

(*a*) The appropriate level of culpability for each particular offense, taking into account the character of the offense;

(*b*) Whether for particular offenses a specific intent should be required, especially where present law contains a requirement of willfulness; and

(*c*) Whether in particular cases penal sanctions are appropriate.

The Working Draft will cross-reference all non-Title 18 felonies, but it apparently does not seek to change the substance of those offenses. We believe this approach is a proper way to have the proposed Code refer to major felonies, while recognizing that non-Title 18 offenses need separate treatment, at a later date. It is not clear from the Working Draft what the Subcommittee intends to do as to the grading and sentencing aspects of non-Title 18 felonies.

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[4] Hereinafter the "Senate Report."

Third, the Working Draft, except in instances where there is a clear proof of the need for change, codifies existing law. Generally, the Working Draft has not become the vehicle for the creation of novel offenses or, for the most part, novel sanctions. The Subcommittee, wisely in our view, rejected the novel and sweeping offense of "reckless endangerment" proposed in Section 1617 of S. 1437, preferring to deal with this problem by fact-specific offenses. The Subcommittee also rejected the offense of "consumer fraud" proposed in Section 1738 of S. 1437 in light of the fact that the Federal Trade Commission was in 1975 empowered under the Magnuson-Moss amendments to the Federal Trade Commission Act, 15 U.S.C. 57b, to pursue the very matters covered by the proposed offense, and that the offense defined in Section 2534 of "executing a fraudulent scheme" provides adequate criminal sanctions against fraud on purchasers. In the area of sentencing, the Subcommittee has properly rejected the devices of restitution and order of notice proposed in Sections 2005 and 2006 of S. 1437. These latter provisions were rejected not only as novel but because they raise both constitutional questions under the Fifth and Seventh amendments and severe practical problems in the administration of criminal justice.[5]

Further we commend the Subcommittee for its work to date in making needed reforms in sentencing which would (i) reduce disparity in sentencing, (ii) give defendants but not the government a right of appeal, (iii) promote public confidence in the criminal justice system by "truth in sentencing measures"; and (iv) assign to the Committee on Sentencing of the Judicial Conference the promulgation of sentencing guidelines.

## III.

The Working Draft of the Subcommittee is, of course, an unfinished document. The Roundtable believes there are significant omissions to be supplied and revisions to be made before the Working Draft is enacted into law. These involve (A) fine levels and sentences, (B) jurisdiction, (C) double jeopardy, (D) corporate records and statements and (E) organized crime offenses. We turn next to a consideration of each of these important matters.

### A. FINE LEVELS AND SENTENCES

1. *Fine levels.*—Section 3502(a) tentatively sets a maximum level of $100,000 for felony crimes and $10,000 for misdemeanors. It makes no distinctions between organizations and individuals.

The Roundtable recommends that a distinction be made between organizations and individuals and that the maximum felony fine for organizations be $500,000, except in antitrust cases where it should be $1,000,000, reflecting the additional resources frequently possessed by organizations. For individuals the maximum felony should remain at $100,000. It also recommends that for misdemeanors the maximum fine for organizations be $100,000 and for individuals $10,000.

These recommendations are consistent with the fine levels in S. 1437 at Section 2201(b). The Roundtable believes that these recommended higher levels will deter organizational and individual crime more effectively.

2. *Alternative fine.*—Section 3502(b) provides that in lieu of a fine under Subsection (a), a defendant who is found guilty of an offense through which pecuniary gain is directly derived may be sentenced to pay a fine of not more than the "gross gain so derived." The Roundtable opposes this novel sentence provision because:

(*a*) It raises serious constitutional questions by confronting any individual defendant with the choice between waiving his Fifth Amendment right not to incriminate himself and foregoing his natural desire to present evidence to limit the amount of the alternative fine either at trial or in the sentencing proceeding. *See North Carolina* v. *Pearce*, 395 U.S. 711 (1969); *Spevack* v. *Klein*, 385 U.S. 511, 514 (1967); *Malloy* v. *Hogan*, 378 U.S. 1, 8 (1964).

(*b*) The provision generates a new set of complex damage issues to be determined in the criminal trial, but does not provide satisfactory procedures for determining the amount of the fine. The Presentence Hearing Procedure at Section 3106 is inadequate to satisfy defendant's due process rights, since the defendant's ability to subpoena and call or cross-examine witnesses is not a matter of right. Moreover, the fact question of the "direct gain derived" will always be heard by a judge—a possible violation of defendants' right to a jury trial.

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[5] See Roundtable Comment of April 28, 1978 at 3–4, 10–20.

(*c*) Because determination of the alternative fine would—especially in regulatory cases—prove complex, nothing short of a post-conviction "trial" may be adequate. Yet such a procedure would delay the imposition of sentence and contravene the well-accepted sentencing principle that, to be effective and fair, a sentence should be swift and certain.

(*d*) The provision fails to address the serious questions presented by the interrelation between this novel criminal fine and civil actions for restitution, SEC disgorgement or antitrust treble damages.

3. *Conditional discharge and probation.*—Current practice includes restitution as a condition of probation where the defendant so agrees or consents. This is a salutary practice which restores victims to their former status, while, because of the consent by the defendant, eliminating the problem of the violation of his due process rights in the determination of the amount of restitution. The Roundtable supports such consensual restitution.

Section 3324(a)(1)(B) "Conditions of probation," however, directs a Court to require that as a condition of a sentence of probation, a defendant make restitution to any victim for any damages or loss caused by the offense for which the defendant is convicted, unless the Court rules restitution is impractical. The provision omits to state that a sentence of probation cannot be entered without the defendant's consent, and we recommend that it do so. Otherwise, Section 3324 would have the effect of establishing the novel criminal sentence of restitution, the very provision which the Subcommittee expressly deleted from the Working Draft.

Section 3304(b)(1) also empowers a Court using the sentence of "conditional discharge" to require the defendant to "make restitution to a victim * * * for actual damages * * * caused by the offense for which the defendant is convicted * * *." The conditional discharge section fails to state that restitution may not be entered without the consent of the defendant. The deliberations of the Subcommittee indicate that "conditional discharge" was intended to be the counterpart for the organization of probation. If so, the provision for making restitution should be consensual for organizations, just as it is in current practice for individuals.

To do otherwise would be to establish, under the name "conditional discharge," mandatory restitution in the face of the Subcommittee's decision to delete restitution as a normal sentence. We note that the Subcommittee rejected the restitution provision found in Section 2006 of S. 1437 for one or more of the following reasons advanced by the members in debate:

> Section 2006 did not establish procedures for courts to determine the victims and the amount of their loss. Neither of these matters is necessarily determined in a criminal trial.
>
> Absent a full evidentiary proceeding (including the right of cross examination), efforts to establish the victims and the amount of their loss may impair defendant's Fifth Amendment rights of due process.
>
> To protect the defendant's rights, and responsibly and fairly determine the victims and the amount of loss probably requires a full-fledged "trial."
>
> Such a "trial," particularly in complex economic and regulatory cases, would delay imposition of sentence, contrary to the well-established rule that sentencing should be swift and certain.
>
> Introducing restitution to the criminal process distorts it. The complaining witness acquires a direct, personal economic stake in the result of the case, threatening the integrity of criminal proceedings. Simultaneously, the prosecutor becomes engaged in private recoveries for individuals, but at taxpayer expense—a questionable application of his resources.

The Roundtable concurs with the views of the members of the Subcommittee concerning nonconsensual Restitution, and would oppose the sections addressing "Conditions of probation" and "Conditions of conditional discharge" if they do not make the restitutional provisions therein consensual.

4. *Prohibition on indemnification for fines.*—Section 3505 introduced the new provision that if a fine is imposed on an agent or shareholder of an organization, "the fine shall not be paid, directly or indirectly, out of the assets of the organization."

It appears that this would prohibit indemnification or insurance covering such fines, regardless of the circumstances, or the good faith conduct of the agent, or the absence of reasonable cause to believe the conduct involved was unlawful.

This is contrary to existing state laws, many of which provide that a corporation shall have the power to indemnify a director, officer, employee or agent against fines:

> if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful.*

The existing state law provision is quite limited and appears fair and reasonable. Section 3505 should be deleted and this question left to state law.

### B. JURISDICTION

1. *Extraterritorial jurisdiction.*—The Roundtable believes that a complete codification of the federal criminal laws should set forth the circumstances under which the United States will asset its jurisdiction over actors and activities primarily located abroad.

The Section 111 of the Working Draft recognizes the issue, but has not yet provided a solution to it.

For conduct abroad to be made criminal, Judge Learned Hand, in *United States* v. *Aluminum Company of America*, 148 F.2d 416, 443 (2d Cir. 1945), stated it is settled law that the conduct outside a state's borders must have "consequences inside its borders which the state reprehends * * *." Section 18(b) of the Restatement (Second) of the Foreign Relations Law of the United States, states that the "consequences" or "effect" in the United States "must be 'substantial' and the direct and foreseeable result of the foreign conduct." There is a presumption against extraterritorial jurisdiction unless a contrary intent is clear. Restatement, supra, Section 38.

The reasons for requiring a substantial interest are well-founded:

(*a*) Prosecutorial resources are limited, and should be applied to significant national purposes.

(*b*) Extraterritorial applications of U.S. criminal law create problems of both enforcement and fairness, which may bear more heavily on the defendant than the prosecutor.

(*c*) The Sixth Amendment right of the accused to compulsory process may be meaningless where foreign witnesses are involved.

The Roundtable believes that the Working Draft should contain a provision which provides for extraterritorial jurisdiction where the offense is committed in whole or in part within the United States, the accused participated outside the United States and there exists a substantial federal interest in pursuing the matter by investigation or proescution. The prosecution should, of course, be consistent with principles of comity. *Timberlane Lumber Co.* v. *Bank of America, N.T. & S.A.*, 549 F.2d 597 (9th Cir. 1976). The provision should further state that a "substantial federal interest" exists where the conduct causes or threatens harm of the type sought to be prevented in any particular offense (i) within the United States, or (ii) to a United States person, or (iii) to the United States.

2. *Restraint in exercise of concurrent jurisdiction.*—Over the last few decades, there has been a dramatic growth of what the Brown Commission called "auxiliary federal jurisdiction," that is jurisdiction over essentially local offenses. This jurisdiction has usually been based on Congressional power over communications facilities, the U.S. mail or interstate and foreign travel. Its exercise has been chiefly a matter of prosecutorial discretion.

This rapid expansion of the federal government's role in local law enforcement has disturbing implications for the preservation of a reasonable balance between the national and state governments. In the 95th Congress, the House Subcommittee on Criminal Justice was particularly concerned about this issue and it appears to have been one of the principal reasons for its failure to accept S. 1437 as a basis for federal criminal law reform:

> [T]he subcommittee's own analysis of S. 1437 led it to conclude that the bill is seriously flawed. [Two] of the most obvious flaws are: overall expansion of Federal criminal jurisdiction, [and] enhancement of the power and discretion of the prosecutor. . . . *Report of The Subcommittee on Crimi-*

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* *E.g.*, ABA–ALI Model Bus. Corp. Act § 5(a) (1979); Del. Code Ann. tit. 8, § 145(a); Ill. Rev. Stat. ch. 32, § 42.12(a); Mich. Comp. Laws § 450.1561; Ohio Rev. Code Ann. § 1701.13(E)(1) and 15 Pa. Cons. Stat. Ann. § 1410(A).

*nal Justice on Recodification of Federal Criminal Law.* 95th Cong. 2d Session (Committee Print No. 29, 1979), 1–2.

We believe the House Subcommittee concerns were reasonable and that this argues for great caution on the part of the Congress in prescribing new federal offenses in any codification legislation. We agree with the Report of the Subcommittee on Criminal Justice that the problem of pre-emption of state and local authority arises not only out of proposals for new onenses, but out of current sweeping applications of the mail and wire fraud statutes.

Section 207 of the Brown Commission Report addressed the problem of concurrent jurisdiction by authorizing federal law enforcement agencies to "decline or discontinue federal enforcement efforts" in cases where "the offense can effectively be prosecuted by nonfederal agencies and it appears that there is no substantial Federal interest in further prosecution or that the offense primarily affects state, local or foreign interests . . . ."

The Working Draft has no comparable provision at present.

The Roundtable recommends a revision of Brown Commission Report Section 207 which would require that the Attorney General promulgate comprehensive guidelines dealing with exercise of concurrent federal enforcement authority. The Roundtable also believes that these guidelines should be given meaningful legal effect.

### C. DOUBLE JEOPARDY

It is a fundamental principle of our constitutional system that a person should not twice be put in jeopardy for the same offense. Unfortunately, the Supreme Court has held that this protection does not apply where the prosecution is in two separate jurisdictions, one federal, one state—the so-called "dual sovereignty" theory of *Bartkus* v. *Illinois*, 359 U.S. 121 (1959) and *Abbate* v. *United States*, 359 U.S. 187 (1959). The dual sovereignty theory simply doesn't take into account the enormous growth of federal criminal jurisdiction overlapping state jurisdiction. This is a rule which should be changed by the Code.

Section 706 and 707 of the Brown Commission Report would have provided a statutory double jeopardy rule barring federal prosecutions where there had been a prior state or foreign prosecution, and barring state prosecutions where there had been a prior federal prosecution.

Section 704 of the Working Draft provides against double jeopardy in the case of a prior trial in a state or local court, while preserving in the Attorney General the right to move in federal district court for an exception where "the interests of the United States would be unduly harmed." We fully support these aspects of Section 704. However, Section 704 does not provide against double jeopardy in the case of a prior action in a foreign country. We recommend that it do so.

### D. CORPORATE RECORDS AND STATEMENTS

1. *Agency subpenas.*—Section 1733 makes it an offense to fail knowingly, in an official proceeding, to comply with an order to produce a record, document or other object. Section 1737(1)(D) defines "official proceeding" to include a proceeding before an authorized agency. Section 1737(2) denfies "authorized agency" to mean an agency authorized by federal law to issue subpenas supported by the sanctions of Section 1733.

Under current law, one cannot normally be in criminal contempt with respect to an agency subpena until the agency has commenced a judicial proceeding to enforce the subpena, a federal district court has entered an enforcement order and respondent has disobeyed it. See, list of statutes providing for enforcement of agency subpena at Sen. Rep. f.n. 54 at 348. In the enforcement proceeding, a respondent may challenge the validity of the subpena on any available legal ground, including the necessity for the required records or testimony and the reasonableness of the burden imposed by the agency's demand. *Reisman* v. *Caplin*, 375 U.S. 440 (1964); *Atlantic Richfield Co.* v. *FTC*, 546 F. 2d 646 (5th Cir. 1977); *SEC* v. *The Boeing Company*, [1975–1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,442 (D.D.C. 1976); *In re SEC.* v. *Isbrandtsen*, 245 F. Supp. 518 (S.D.N.Y. 1965); *International Waste Controls, Inc.* v. *SEC*, 362 F. Supp. 117 (S.D.N.Y.), aff'd per curiam, 485 F. 2d 1238 (2d Cir. 1973).

Section 1737(2)'s definition of "authorized agency" does not clearly preserve current law and, as a result, could have the unintended effect of permitting federal agencies to bypass the district court enforcement proceeding. The section should be amended to provide that, unless otherwise stated, the sanction should be

available only after there has been an opportunity to challenge the subpena on any available legal ground in a district court enforcement proceeding.

2. *Private information submitted for a Government purpose.*—The House Working Draft does not contain the offense of revealing private information submitted for a government purpose. We undertsand that the Subcommittee has made no decisions in this regard. Current law contains such an offense at 18 U.S.C. 1905. The Roundtable recommends that the Subcommittee include such an offense in subsequent drafts.

Private information submitted for a government purpose includes proprietary information (trade secrets, processes, operations, styles of work, apparatus, pertinent data), important financial and statistical data (income, profits, losses, sales, expenditures), and other material in the ever-widening scope of government inquiry and regulation. Much of industry's very lifeblood is included in "Private Information Submitted for a Government Purpose."

The business community recognizes the necessity of individuals and organizations submitting much of this information to the government, but believes that this data must have the greatest possible protection and that government personnel need to be on the clearest possible notice about their duty to "handle with care" that information.

The Roundtable urges the adoption of 18 U.S.C. 1905, making illegal any disclosure "not authorized by law.' It believes that the language describing coverage suggested in Section 1525 of the Senate Committee Print of May 21, 1979 *i.e.*, "any information" is preferable to the specific categories mentioned in 18 U.S.C. § 1905, and recommends adoption of that phrase.

### E. ORGANIZED CRIME OFFENSES

The Business Roundtable supports in principle Sections 2701–06 of the proposed Code, which are entitled "Racketeering." However, it believes that these provisions should be amended to make clear the legislative intent that they are not directed at offenses by bona fide business organizations.

The problem arises because the Sections 2701–06 applied literally can bring a legitimate organization within their scope if an organization engages in two separate acts of "racketeering activity.' Which is broadly defined in Section 2706 to include mail fraud, wire fraud, transportation of goods or money taken by fraud, bribery or fraud in the sale of securities. Section 2706 provides that one act must be after the effective date of the Code. Yet the sentences for the basic organized crime offenses presently are severe: forfeiture, jail sentences and fines. The Working Draft proposes jail sentences of convicted individual defendants of up to 160 months (Sections 2701 and 3702), fines of up to $100,000 (Sections 2701 and 3502(a)) and "Civil Restraint on Racketeering" of an unspecified nature (Working Draft pp. 258 and 260). Moreover, the stigma of a conviction under these provisions would be devastating to a bona fide organization.

The opportunity for prosecutorial overreaching created by the broadly drafted racketeering and organizational complicity (see p. 5 above) sections is troublesome. The wide range of culpable activity encompassed by the racketeering offenses would permit a prosecutor to bring racketeering charges with evidence only of offenses that would normally warrant less severe sanctions, such as a corporate fine. By refusing to plead guilty, and defending its actions on the merits, the corporation would risk becoming subject to mandatory forfeiture provisions that could put it out of business, destroy its stockholders' investment and its reputation. If the prosecution were successful, the resulting mandatory criminal sanction would be totally disproportionate to the severity of the misconduct charged. Under these circumstances, the barest threat of prosecution under the racketeering sections could be used as a club to extract corporate guilty pleas to lesser charges, regardless of the legal or factual defenses the corporation might otherwise have available.

The Roundtable supports these organized crime offenses in principle, but it believes amendments should make clear that the provisions do not apply to legitimate businesses convicted of offenses, but to individuals and to organizations established primarily for the purpose of engaging in conduct described in Sections 2701–06.

## IV. CONCLUSION

The Roundtable commends Chairman Drinan and the members and staff of the Subcommittee on Criminal Justice of the Committee on the Judiciary of the

House on the conscientious and effective work done to date in the codification of the federal criminal laws. If as we hope, the subcommittee makes the changes here suggested and the other provisions of the Working Draft are not materially altered, The Roundtable would expect to support the Criminal Code proposed by the Subcommittee.

Thank you.

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The CHAIRMAN. Senator Metzenbaum, do you want to make a statement?

## OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. Thank you, Mr. Chairman. Mr. Chairman, I too want to commend you and the ranking minority member for your willingness to schedule these hearings. I am confident that the time we will devote to these matters will be very well spent.

I would certainly count myself among those who have serious doubts about the vigor with which the Justice Department pursues corporate lawbreakers. I take strong issue with the Attorney General's assertion that his Department has "prosecuted every defendant, whether it be corporate or individual."

Now, as we thoroughly examine this issue, I expect we will see a disturbing pattern emerge, one which exposes a two-tiered system of justice in this country. It is my sincere hope that we can look back on these hearings as a beginning of the end of that two-tiered system of justice.

Now, at the outset it is imperative that we understand that faith in the law and faith in those who execute it are the inseparable bedrocks of our democratic system; therefore, it is not difficult to understand that public confidence in our system is shaken when executives are allowed to take refuge behind a corporate logo while ordinary citizens are accorded no such sanctuary.

Let me make it clear. I fully expect that officials from the Justice Department will appear before us and cite a glowing record of successful prosecutions of companies and executives. I would hope that they can cite these examples, for that is their job. That is what the American people pay our government lawyers to do.

But more importantly, what I expect to find is that too often white-collar crimes are either ignored altogether or disposed of with a face-saving gentleman's agreement. When we talk about white-collar crime, a number of things come to mind.

Procurement fraud, money laundering, insider trading, price fixing, check kiting, and on and on and on. The committee will examine cases involving this kind of wrongdoing by a number of name-brand corporations—E.F. Hutton, General Dynamics, General Electric, Rockwell International, as well as many others.

I am most interested in these cases and I look forward to exploring them with my colleagues in the coming weeks. But there is a type of crime that is often left out of this litany. The category which often goes unmentioned can be described as corporate crimes of violence. The Justice Department describes these cases as economic crimes, but the real tragedy in these matters is not economic. These are indeed crimes of violence.

Corporate crimes of violence result in the injury and death of innocent individuals. Too often the victims of these crimes are those who are most vulnerable—the very young, the very old, the ailing. Companies which manufacture the foods we buy and the medicines we rely on have a very sobering responsibility to insure that the products they sell us are both safe and effective. Tragically, sometimes those responsibilities have been shirked.

It is in the area of violent white-collar crime that I believe the Justice Department has particularly sidestepped its responsibilities, and the American consumer pays the price.

These corporate crimes of violence are among those the committee will examine. The *Syntex* case: The Syntex Corp. produced and sold a defective and mislabeled baby formula which threatened the lives of 20,000 infants. In the end, some babies died and some were permanently injured. The Justice Department refused to file a single charge, despite the fact that the Department's witness before us today was told by another Department of Justice attorney that the evidence in the case was "undisputed" and the company had violated our food and drug laws.

In fact, the Justice Department said—and this is one of the most amazing statements I have ever heard since I have been around Washington—that it would not be in the interest of society to prosecute those responsible. For the life of me I cannot understand how it would not be in the interest of society to prosecute those who allegedly are guilty of crimes having to do with the health of children. That statement sticks in my mind as probably the most callous and shameful I have heard in many a year.

The *Smithkline* case had to do with a substance called Sulequin, a drug which was supposed to treat patients suffering from high blood pressure. It was pulled off the market after 8 months. The drug had been linked to at least 36 deaths and 500 injuries. Smithkline officials had failed to report adverse reactions to the FDA, as the law requires.

The company was fined and three individuals were sentenced to perform community service work, after the Justice Department decided to seek only misdemeanor charges.

A third pharmaceutical company, Eli Lilly, produced a product called Oraflex, a drug that was touted as relief for arthritis sufferers, was introduced in America with a $12 million public relations blitz. First, the FDA complained that Lilly's claims about the drug were "less than ethical," as well as "false and misleading."

Later, Oraflex was linked to 26 deaths and 200 serious side effects. Although the Justice Department found that Lilly had not reported adverse reactions to FDA, misdemeanor charges were filed. No felony charges were brought, no one went to jail. The company and one doctor were fined a total of $40,000. It would be laughable if it were not in connection with the subject that indeed would make us cry.

Mr. Chairman, the Justice Department argues quite strenuously that their record on corporate crime is far superior to any previous administration, and I am not prepared to debate that issue because I do not really think that is the important issue.

I am not here saying that previous administrations' efforts or lack of efforts are not above criticism. As a matter of fact, I am particularly interested in a matter which predates this administration. One of the issues I want this committee to probe in detail is what happened to the 1977 Food and Drug Administration request for a criminal grand jury investigation and to possible fraud and test to determine the safety of NutraSweet, a food additive presently being consumed by over 100 million Americans.

The FDA asked for a criminal investigation of the G.D. Searle Co. for "concealing material facts and making false statements" in reports of animal studies conducted to establish the safety of NutraSweet and another Searle drug.

It is a fact, Mr. Chairman, that the FDA's request for an investigation of NutraSweet was never put to a grand jury. It is a further fact that the Justice Department itself in Washington was pushing the U.S. attorneys office in Chicago as to why the matter was not being moved forward.

It is also a fact that two U.S. attorneys involved in that case were later hired by the law firm which was then defending Searle in the investigation. It is a fact that both the FDA and the main Justice Department complained about delays in the investigation.

Mr. Chairman, we are talking about a food additive which is in everything from softdrinks to pudding to children's vitamins. As a matter of fact, the company itself is telling children in advertising that NutraSweet, "that's the good stuff," and at the same time the FDA is out making speeches indicating that too much ingestion of that product may cause a problem about which they cannot be sanguine.

The failure to at least investigate charges that safety tests were fraudulant causes me grave concern and I hope we will get to the bottom of that issue. I want this committee to utilize its full subpoena power to conduct a thorough investigation into why the NutraSweet grand jury investigation was dropped. I will work with you, Mr. Chairman, and the other members of the committee as well as your staff in an effort to discover what really happened back there in 1976 and 1977.

We may now, I am afraid, be at the point in history about which Chief Justice Earl Warren warned us over two decades ago. He cautioned that unless we hold the flesh and blood behind the corporation responsible for wrongdoing in the name of the company, our laws would become mere license fees for illegitimate business operation.

The government of laws only functions if those governed believe that the laws are being fairly enforced. There is no room for bowing to the privileged few, when the final analysis of the motivation for all Americans to act within the law stems at heart from the knowledge that the laws are being fairly and impartially administered.

I believe the American people's faith in that principle has been eroded. Unless we can restore that faith, the motivation for every citizen to act within the law is likewise eroded.

Thank you.

## OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. Thank you, Senator.

This afternoon, the committee begins a series of hearings concerning the sophisticated, complex crimes that have traditionally been known as white-collar crime, and the adequacy of current law and law enforcement efforts directed at the problem.

Today's hearing and a hearing scheduled for next week will provide a general overview of this area of law. Then, in the following 2

weeks in March, the committee will examine the types of illegal activities perpetrated in financial institutions. Other hearings will examine crime in defense procurement and in the pharmaceutical industry.

These hearings are a continuation of a long-standing tradition of this committee to undertake the review of our criminal laws in a comprehensive, bipartisan manner. For years, the members of this committee, under both Democratic and Republican leadership, worked to reform our Criminal Code.

That effort culminated in the passage of the Comprehensive Crime Control Act of 1984, which has given us some of our most effective tools against white collar crime. We have undertaken these hearings in that same bipartisan spirit, and I commend the distinguished ranking member, Senator Biden, for his involvement in planning these hearings.

As we begin our initial inquiry in this area, it is worthwhile to place our subject in historical perspective. Traditionally, the term "white-collar crime" has been used to distinguish between nonviolent crimes committed by middle- or upper-income class individuals, as contrasted with violent or "street" crime.

Over time, the general connotation of the term "white-collar crime" has been narrowed to indicate a criminal activity perpetuated in a business or corporate setting. However, recent developments have questioned whether the distinction between white-collar crime and general crime is either valuable or accurate. Indeed, more appropriate distinctions might center on whether the crime is violent or nonviolent, simple or complex.

Those criminal acts that have been classified as "white collar" should be described as completely and as accurately as possible, in order that society can best address them. Perhaps the terms we use should be descriptive of the act involved: Instead of labeling it "white-collar" crime, we should speak of drug analog manufacturing, or complex corporate fraud involving Government contracts or pharmaceuticals. Calling money laundering "white collar" seems to insulate it from the reality that it may be merely a continuation of a crime cycle which originates with drug dealing in our cities' streets.

Despite the label we give to these acts, many people feel there is something inherently different about this type of criminal activity. The questions we must address in these hearings include:

What are these differences? Are these activities intrinsically different from our traditional notion of what "crime" is? Can these activities be explained by our traditional definitions of crime, and are they susceptible to our traditional response to criminal activity? Are these actions somehow perceived as less threatening to individual citizens? Are these crimes more complex in their undertaking? Do they represent the "state of the art," both in methods and technologies used by criminals, and in legal theories devised to outlaw such acts? Is the societal stigma attached to such crime somehow less severe to the perpetrators than the stigma attached to other crimes? Are our legal and law enforcement resources and approaches capable of addressing these crimes?

During these hearings, we will be working with many people—academics, corporate executives, and those actually involved with

daily law enforcement, both at the State and Federal level—as we seek to answer these questions. We will also look at specific cases in an attempt to understand the real-world complexities and approaches used in this area.

Today we have with us the Deputy Attorney General. We look forward to having the benefit of his insight today, and to having other representatives of the Department of Justice, and other agencies with us to discuss specific issues as we continue our inquiry in future hearings.

Now I shall call upon the able ranking member here, Senator Biden, for any statement he wishes to make.

Senator Biden.

**OPENING STATEMENT OF SENATOR JOSEPH R. BIDEN, JR.**

Senator BIDEN. Thank you, Mr. Chairman. I will take only about 5 minutes.

Mr. Jensen, welcome. I think it is critical that we—and you have already done it in large part—set the stage for what these extraordinary hearings on white-collar crime are going to be about and what they are not going to be about.

In the 12 years that I have served on this committee, there have been a few occasions when we have agreed on a bipartisan basis to delve so deeply into a single subject. In recent history, the reform of the Criminal Code and the consideration of the Comprehensive Crime Control Act of 1984 come most immediately to mind.

But something different is called for here, something about the headlines which have bombarded us day after day, stories of widespread fraud, gross negligence and other forms of corporate malfeasance. They compell us to see the issue of white-collar crime in a different light, in my view.

We can no longer ignore the concerns expressed by our constituents or growing fear in our own minds that white-collar crime has now reached crisis proportions. Let me read to you just some of the latest disclosures, which you are all aware of, but to make the point.

Headline, "Payoffs Seem Rampant in Defense Contracts." Washington Post, February 25, 1986:

> The practice of paying kickbacks is rampant among defense subcontractors, according to investigation by Senate Government Affairs Subcommittee on Government Management. Defense contracts have risen so much, to roughly $47 billion a year, that the problem of fraud has increased in volume. The investigators could give no estimate of how much money is passed under the table.

Headline, "General Dynamics Temporarily Barred From New U.S. Work After Incident," New York Times, December 4, 1985.

Headline, "Navy Moves To Allow General Dynamics To Bid for New Job Despite Suspension," New York Times, December 5, 1985.

Headine, "U.S. Sweetheart Deal Alleged, Justice Denies Pressuring GE Ex-Official to Settle Lawsuit," Washington Post, February 9, 1986.

Headline, "White Collar Crime Booming Again," states a lengthy piece in the New York Times.

Headline, "Economic Pressure on New Pervasiveness and Simple Greed Are Eroding Corporate Morality," again June 1985.

It would be awful easy for us here, based on those headlines and many others, we are all familiar with, to take off on our own version of a witch hunt. We could insist upon subpoenaing everybody in the world, we could demand documents, we could cast blame all around, we could be selective in our blame.

We could pick 1 case and we could pick 10 cases, we could attempt to solve the crime, searching for that one corporate official who may wittingly or unwittingly have been at fault and we would undoubtedly attract a lot of press and make a lot of headlines.

But I do not believe for a moment that we would do much to cure the disease, which is eroding our national pride and sapping public confidence in our most basic legal and financial institutions, and that is why the distinguished chairman, Senator Thurmond, and I sat down with the advice and consent, if you will, to steal a phrase, primarily from the Senator from Ohio, and from the Senator from Iowa, to work out a strategy, with which we could proceed that would produce some positive results.

I congratulate and thank him again for doing what some might suggest would be a politically difficult, dangerous thing to do in an election year, but let me tell you what I in my mind, what are the three overriding guides to this inquiry, and I do not hold the chairman precisely to these but I think we are in sync.

The first one is are the personnel in the Justice Department competent to get the job done, do they know how to investigate and prosecute sophisticated white-collar crime cases; and, second, are those individuals being allowed to do their job, does political or philosophic bias against these kinds of prosecutions exist in the department, and/or does the Justice Department have the legal tools required to get the job done? Do we need to legislate new standards? Are there in fact—has the Justice Department been totally competent and well-trained people and well intended but they just don't have the tools, or has the judgment been made by us as a society through our Congress and former Presidents and present President of the United States that these are things that we do not want to have to deal with?

So really we have got to deal with it straight up. We have got to somehow address the mounting, in my view, the mounting impression, whether it is real or not, in the minds of the American public that in fact if you are big you do not pay, if you commit a crime and you are a corporation you somehow are absolved indirectly, and that to me is what these hearings are about and it comes down to essentially one of three things.

Either we do not have the laws on the books to allow Justice to do the job that I think the public wants them to do, or, two, Justice has the laws but, like in the Carter administration, so I spread this across the board, did not know how to use forfeiture very well, notwithstanding the fact that it existed there, were not nearly as effective as this administration, with RICO, was not nearly as effective as this administration with continuing criminal enterprise statute, is because when we went to the hearings we found out that we didn't train our folks to use it.

We had hearings back in the seventies where we found out prosecutors did not know how to use the law. It had been on the books for 9 years and they did not know to use it.

I compliment publicly Mr. Jensen and the Department for teaching the prosecutors how to use those tools and using them. But what about white-collar crime? Are the tools there and Justice folks do not know how to use them or not use them skillfully?

And third, which I quite frankly at the outset will state I doubt very much, is in fact the Justice Department's attitude indirectly complicitous, is there a mindset like there was on antitrust with the former head of the Antitrust Division, that although the law is there, although we know how to use it, we should not use it because the law does not make any sense, is that the case?

Well, the answer to our questions, it seems to me, that after these hearings are over we will have arrived at one or all of those conclusions, and I think that is the function of the hearings.

We are going to examine a number of areas and consider a number of cases before our study is completed. First, we are going to get an overview of the problem from the Justice Department. That is why Mr. Jensen is here today, our sole witness, I believe is prepared to sharply focus as possible the picture of the Department's white-collar crime enforcement efforts.

In a followup hearing next week, we are going to hear from some very distinguished academics who have studied the phenomenon of white-collar crime in depth, garnering information on public attitudes toward this kind of criminal behavior and to the extent to which it has invaded corporate values and corporate structures in this country.

So I should say to the folks in the audience that I suspect, if you are looking for fireworks, this is going to be a pretty dull first two hearings, but hopefully they will be thorough. Hopefully, we will set the groundwork on determining what we are going to be dealing with here.

And after the first 2 days of hearings we will turn our attention to some very specific areas of concern and, accordingly, we will focus on some important individual cases.

The chairman and I have agreed to take an indepth look at first fraud in financial institutions, then Defense Department procurement fraud cases and then criminal food and drug violations. Each of these hearings will encompass 2 to 3 days of hearings and in some instances, depending on the testimony, it could be more.

We will call as witnesses top executives from these corporations charged with serious crimes, prosecuting attorneys and officials from relevant Government enforcement agencies. We will then, if necessary, I hope subpoena witnesses and demand documents, if it is appropriate, based upon what the days of hearings demonstrate.

At the end of this entire process, we expect to hear from top policymakers again in the Justice Department. Unless I misunderstood the chairman, Mr. Jensen, I believe we will invite you back, welcome you back at the end of this process to comment on what we have found or not found, what our individual impressions are at that point, including hopefully the Attorney General himself at that time.

Let me emphasize that this is a cooperative effort and I hope it will be treated as such. The knowledge this committee gains will serve everyone as we seek to make the necessary reforms in the law and its administration.

Let me be more specific, Mr. Jensen, particularly as it affects the Justice Department. We have concluded to make this a bipartisan process. I hope we can also conclude to make this, if you will, a bigovernmental process and that is we need your help. We need Justice's help as we go through this process in terms of you being willing to give us access to documents and/or insights as these witnesses come up. I welcome, as one member of the committee, your knowing the itinerary of the hearings, your knowing the witnesses, and I would sincerely hope that if you, knowing what we are about to undertake in the hearings have any information you think would be useful to impart to set us in the right direction or to help us in our efforts so there would not be duplication, I truly would appreciate it and welcome it.

Finally, we are looking forward, if the conclusion warrants, to drafting and processing whatever legislation is necessary and appropriate to aid the United States of America, the Government of the United States of America, the enforcement arm, the Justice Department in providing for the best possible prospects to bring to justice people who have violated what we will have determined collectively should be or are the laws of this country.

Mr. Chairman, you and I have agreed to work together in a bipartisan basis, as we have so often in the past, and we are determined to do that and I do not think anyone will divert us from that course and, Mr. Chairman. I make a dangerous prediction here. I think that you will and your entire career here in the U.S. Senate, which has been long and distinguished, probably there is no single effort that will live as long beyond your moving from this body, which probably will not occur until the year 2010, than what you brought to fruition in the Crime Control Act.

Everybody tried it before you, and no one did. I suspect you are going to end up doing a similar thing in the white-collar crime area.

Thank you.

The CHAIRMAN. Thank you, Senator.

The distinguished Senator from Iowa, Mr. Grassley.

## OPENING STATEMENT OF SENATOR CHARLES E. GRASSLEY

Senator GRASSLEY. Thank you, Mr. Chairman. I want to thank you and all the others who worked so hard to convene this series of hearings on the growing concern of white-collar crime in America.

Of course, I, like everybody else, look forward to what I anticipate will be a very educational and productive effort by this committee to grapple with the problem that has no quick and easy solution.

In the last year alone we have seen new cases involving well-known corporations and individuals entangled in money laundering, check kiting, insider trading, defense procurement fraud, and other types of business crime. Consequently, the question is not whether the problem exists, but what is the extent and how can it be controlled.

I feel these crimes are proliferating because of two major reasons: One, declining ethical standards within the corporate commu-

nity, combined with high profit demands; and, two, lack of enforcement of laws producing only minimal penalties.

As a result, there is a widespread impression that white-collar crime does pay and is therefore worth the risk involved.

Mr. Chairman, as you know, my subcommittee of this full committee has spent a great deal of time over the past 2 years studying how our Federal Government protects itself and protects taxpayers' funds from white-collar crime. More specifically, our examination has focused on how the Government polices against fraud in the defense industry.

Unlike some other types of white-collar crime, where State and local law agencies can also play a role in the enforcement efforts, the Federal Government has sole responsibility for protecting the billions of dollars devoted to defense procurement.

It is our duty as legislators and as overseers of the Federal law enforcement agencies to study the system, its weaknesses, and to take necessary corrective action. I look forward to the hearings scheduled later this spring where we will have a chance to explore in depth white-collar crime in defense procurement.

Once again, I want to thank you, Mr. Chairman, and commend also the ranking minority member, Senator Biden, for acknowledging the importance of this problem and making this effort to address it in a very comprehensive manner.

Thank you, Mr. Chairman.

[The prepared questions of Senator Grassley follow:]

SENATOR CHARLES E. GRASSLEY QUESTIONS FOR MR. JENSEN

(1) Mr. Jensen, as you know, the Justice Department has sent up to us its proposal for next year's budget and it includes a $500 million increase. Can you please tell us to what extent resources devoted to economic crime law enforcement will be increased, decreased or stay about the same?

Please specify new budget plans for the defense procurement fraud unit—for the Criminal Division Fraud Section—for units in U.S. attorneys office devoted to white collar crime.

(2) Mr. Jensen, earlier in this administration, the Justice Department had an economic crime office or unit which included about 20 attorneys stationed in United States attorneys offices around the country with the specific mission of targeting white collar crime. A few years ago, however, that unit was disbanded and the attorneys were converted into assistant U.S. attorneys who would handle a variety of litigation.

I know in your testimony you have mentioned what is now a policy group called the Economic Crime Council, but can you explain why the Justice Department chose to reorganize that original group of attorneys and whether there is now any unit devoted solely to prosecuting white collar crime?

(3) According to a study by Wisconsin's Professor Clinard a few years ago (1979), white collar criminals only spent an average of 2.8 days actually in prison for their crimes.

(A) I would like to know what the average sentence for a white collar crime is and;

(B) What is the average time actually spent in jail for these crimes?

(4) Mr. Jensen, I have noticed that in response to complaints about relatively low penalties in white collar crime cases, the Justice Department has indicated that its recoveries are constrained by statutory limits.

As you know, the civil RICO statute allows for treble damages but the Government did not bring any civil RICO actions until 1985, according to Justice Department testimony.

Can you tell me why Justice waited 15 years to try to utilize this treble damage tool against white collar crime?

[Answers not available at press time.]

The CHAIRMAN. Thank you.

A few minutes ago I failed to call on you, and I apologize for it, and your statement will appear in full in the record.

Senator BIDEN. Mr. Chairman, I ask unanimous consent that Senator DeConcini's opening statement be put in the record as if read at the conclusion of the opening statements.

The CHAIRMAN. Without objection, that will be done. Also an opening statement of Senator Hatch will be placed in the record.

[Statements follow:]

OPENING STATEMENT OF SENATOR ORRIN HATCH

Mr. Chairman, I commend you for setting aside time from the busy schedule of the Judiciary Committee to explore the effects of and ways to improve our battle against crime. It will undoubtedly be counted as one of the greatest of your many contributions to this Nation that you were presiding over the Senate Judiciary Committee at the time of the enactment of the Comprehensive Crime Control Act of 1984. That act has strengthened our ability to fight crime of all varieties.

The full effect on our Nation of so-called white collar crime cannot be adequately documented. I am aware that in 1974 the National Chamber of Commerce estimated the annual cost of white collar crime to be somewhere in the neighborhood of $40 billion. Peat, Marwick, & Mitchell suggested 8 years later that that figure had swollen to at least $200 billion. We will perhaps never know, however, the full tragedy of crime, whether it is preceded by the adjective "white collar" or not. Statistics tell us a grim tale, but even they do not reflect the anguish of a family that has lost its savings to a fraud scheme or the sorrow of a community suffering from toxic waste dumping or any of the other forms of illicit activity.

Crime is crime. This committee has always worked closely together in an effort to provide the Justice Department with the tools to fight bribery, extortion, tax fraud, embezzlement, antitrust violations, investment fraud, environmental fraud, misuse of funds, food and drug violations, and all of the other forms of dangerous conduct that we will be exploring today and in subsequent hearings. For my part, I pledge myself to continue to work with the Department of Justice and other law enforcement agencies in this battle against crime. If there is anything that this committee can do to aid that battle, I am sure that we will cooperate as we have in the past to facilitate prosecutions and appropriate actions against crime.

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OPENING STATEMENT OF SENATOR DENNIS DECONCINI

Mr. Chairman, thank you for your cooperation in scheduling this extremely important series of hearings on white collar crime.

Senator Biden, I want to especially thank you for the tremendous amount of time and effort you have dedicated in coordinating these hearings. You have continually demonstrated your leadership on the Judiciary Committee and this is another example of that leadership. Your commitment toward addressing the escalating problem of white collar crime is commendable. The Judiciary Committee has oversight responsibility for the Department of Justice and I am pleased that with Senator Biden's lead we are more actively carrying out that responsibility.

As a former prosecutor, I have had a long interest in crime and crime prevention. The economic crimes that have been brought to light in recent years illustrate the severity of this problem. Not only do these crimes result in significant economic loss to both business and consumers, but they have a tremendous impact on the public's perception of corporate fiduciary responsibilities, of the existing law, and of enforcement procedures. However, I am pleased that we will be hearing testimony about companies that are operating honestly as well as those that have operated dishonestly. There are standards of performance which, if followed, result in productive and profitable business operations. We need to hear testimony about these good and honest practices, too.

Mr. Chairman and Senator Biden, may I again thank you for your efforts in addressing this issue. I look forward to the upcoming hearings and working with you toward a solution to this problem.

The CHAIRMAN. Mr. Chairman, we are very pleased to have you here. It looks like you have a statement here of about 52 pages which would probably take about 1¾ hours to deliver. I wonder if

you feel you could brief it some, or give us a synopsis, or give us the heart of it without taking that long.

We will insert your entire statement in the record, if you would like us to put it in the record.

## TESTIMONY OF D. LOWELL JENSEN, DEPUTY ATTORNEY GENERAL, U.S. DEPARTMENT OF JUSTICE

Mr. JENSEN. Thank you very much, Mr. Chairman, Senator Biden, Senator Grassley, Senator Metzenbaum. I quite frankly appreciate the opportunity to be here on an auspicious occasion. I believe that we do have an opportunity to do something that could very well be historic.

I think that I would like to build upon the sentiment that has already been expressed here. We need to look at this issue as one that is particularly troubling and pernicious for this country. It is of a great and serious dimension and we need to look at it with clear eyes so that we are able to sweep away any misperceptions or misimpressions. We will talk about the same things and we will be pointing our fingers at the problem, rather than at one another, which I think is the attitude that is already here.

I think the point has been made that this committee has done some remarkable things in the criminal justice area and I think the reference to the Crime Control Act of 1984 and your leadership and that of Senator Biden is well chosen. It was a truly bipartisan effort and I think that it has done a great deal to assist the criminal justice process in this country at the Federal level. I think that starting here as a bipartisan effort to look at white-collar crimes in the fashion we are doing is very healthy and very constructive.

It is a real privilege to be here and to be able to start with essentially an overview from the perspective of the Department of Justice. After all, we do have responsibilities that are directly relevant in terms of, as already pointed out, our need to marshall our resources, our need to manage our resources, our commitment to the use of the civil and criminal process of this country to address this, as I say, pernicious problem.

So I welcome the opportunity to address this on a broad ranging basis and, as has already been pointed out, it appears that we will be able to look at more specific areas along the line and we will be very happy to offer our assistance, to offer our thoughts in this respect, and to produce the kinds of information, people and documents that will support your efforts.

We will look at that as we have done in any other cases, and any of the issues that might be there that we need to thrash out because of different interests or different responsibilities, we will do that. We approach this with a very constructive frame of mind and I hope that we will come out of this with a sense of what is necessary in terms of national commitment, and a sense of what can be done to make the most appropriate legal framework available. We will look at our legal structure and see how we might change that.

As a matter of fact, we do have some thoughts in that regard that I will address very briefly later on. So with that, and I also appreciate your taking my testimony in for the record and I will try to abridge it. I think there are some points I would like to

make at this oversight hearing. This hearing gives us an overview and a broad range of perspective, and I will try to abridge that as I go through.

Let me also say, Mr. Chairman, that we have done something a little bit different here. Often actions speak louder than words and we will have a lot of words here but there are some actions that we have taken that we would like to bring to the attention of the committee. We have a compendium here of actual cases that have been handled by the Department and we have gone out to our different divisions and U.S. attorneys who actually do all the work and we have got something like 400 cases that we have actually put into place in the criminal justice system. We think that that is the kind of thing where actions speak louder than words and we would like you to look at that.

Now, I do not know whether you put that in the record. I offer that for the record if that is what you want to do. In any event, we make it available to you and your staff and everyone here to take a look at what is essentially a statement about what we have been doing. Without any varnish at all, these are the cases and they express probably as well as we possibly can our commitment in this area, what we can produce, what we have produced, and where we hope to go.

The compendium of cases has been put together for the purpose of giving you a background and an overview of where we are in the Department. As I say, it is available and if you would like to put it in the record, we would certainly like to offer it.

The CHAIRMAN. Mr. Jensen, it would cost a fortune if we put everything in the record, so I think we might file it in our files and have it available.

Mr. JENSEN. That is why I did not ask for it directly, I thought that is a judgment that you should make, Mr. Chairman.

The CHAIRMAN. It has been suggested that all the witnesses at all these hearings be placed under oath and so if you would not mind standing and take the oath, I will give you the oath.

Mr. JENSEN. Certainly.

[The witness was sworn.]

Mr. JENSEN. If I could start then, Mr. Chairman, I have already talked about the notion that white collar crime is a label for a species of crime and it is a term that probably got into the criminological literature something like 35 years ago.

The concept of the categorization was new, but the offenses were not. The Department of Justice then prosecuted these kinds of crimes as we do now, but we now have accepted and over a period of time we have used this loose categorization as a useful kind of device for labeling forms of criminality and of our response to it.

Over the span of several administrations, the Department of Justice has devoted attention to this category of offenses. In 1974, the term "white collar crime" appeared for the first time in the annual report of the Attorney General. Shortly thereafter, 15 percent of the manpower of the FBI was reallocated to investigation of such crime. A Public Integrity Section was established in the Criminal Division. The Fraud Section was expanded in that division.

In the late seventies, the Criminal Division experimented with placing specialists in various U.S. attorneys offices around the

country. In 1979 we began training senior assistant U.S. attorneys in more sophisticated white-collar prosecutions. In 1980 we started the process of identifying white-collar crime priority programs. In 1981, we started a special tracking system to help manage our white-collar crime prosecutions. In 1982, we established a Defense Procurement Fraud Unit. Later that same year, we created the Environmental Crimes Unit. In 1983, the Department Established an Economic Crime Council, to which I will allude later on.

In 1984, we developed an interagency task force to look at the issue of bank fraud cases. We have developed programs to reach collusive bidding programs, with reference to antitrust prosecutions. Later that year, we started a National Environmental Enforcement Conference that I will describe more specifically in the rest of this testimony.

As we have gone on and we have sharpened our investigative and prosecutorial attention on white-collar crime, we have reached cases in greater numbers and hopefully in greater significance and importance.

Our progress in this area in the Department over a period of time, and not just this Department, has been accelerated. I think we are achieving more significant results now than we have ever before in history.

We frankly are proud of that effort. We recognize, however, at the same time that there is a great deal more to do. As has already been pointed out, in order to accomplish that we have to do it as a bigovernmental effort, as has been stated, and we appreciate that very much. We welcome your advice and we expect your help in that regard.

I think for that reason I would like to give you a record of our priorities, our understandings, our initiatives and some of our results. We think that that public review, as I said before, is worthwhile and timely and we would like to commence that today.

As you have already pointed out, we will have further hearings in specific areas and we will have and schedule the individual assistant attorney generals with direct responsibility to participate in these hearings. We will address more specific topics later on, and so I will confine my remarks at this time to a more general description of the broad topics that are of relevance, I believe, to your oversight of the Department of Justice.

Let me talk about five major topics. First, I would like to discuss with you the nature and seriousness of the problem we face; second, the general principles that guide our efforts; third, the management practices we have adopted to facilitate our work; fourth, the enforcement results we have achieved; and, finally, the measures we believe are necessary for continued success.

As I indicated, other departmental witnesses will be available to supplement this testimony in the hearings to come.

We start with the nature of white-collar crime. Such crime is an insidious form of criminality, it is so serious and pervasive a threat to the Nation's well-being that it requires a high degree of attention at the Federal level.

By "white-collar crime," we generally mean to denote a broad range of nonviolent criminal activity that either threatens or injures important governmental, economic, or social interests. Those

interests include the integrity and effectiveness of government institutions, processes, and programs; the economic well-being of business enterprises, consumers, investors, and employers; and the physical health and safety of the general public.

Thus, we use the term "white-collar crime" to encompass such offenses as bribery and corruption of officials at all levels of government; procurement fraud; tax fraud and fraud against government programs; bank fraud and embezzlement; consumer fraud and antitrust violations; securities, commodities, and other investment fraud; misuse of union funds and labor bribery; and environmental crimes and food and drug law violations.

Invariably, these offenses are motivated by a desire for economic gain or advantage. They are usually carefully calculated. They are also commonly carried out surreptitiously by deceit, concealment, or breach of trust, beneath a veneer of legitimacy and respectability.

These and other aspects of white-collar crimes make them extraordinarily difficult to investigate successfully. Unlike so-called "street crimes" and other violent offenses, white-collar crimes frequently are not self-evident. Due to the use of subterfuge and concealment—usually involving deception—often not even the victims realize that they have been defrauded until long after the event. Even then, investigators must painstakingly work their way through complex "paper trails" before they can determine whether or not the law was violated, whether the violation was criminal, and who was responsible.

In addition, perpetrators of white-collar crime are frequently sophisticated in business matters, and able to exploit the complexities of modern accounting and banking techniques to obfuscate their actions and to confuse those who might attempt to uncover them.

They are quick to employ the latest advances in supporting technology, particularly the use of computers. Moreover, they often design their enterprises to take advantage of limited jurisdictional boundaries by which law enforcement agencies are necessarily constrained, thus working, for example, in one location while their victims are in another location.

As I indicated, these offenses are very difficult to follow in that they are usually paper cases and they may take access to and painstaking analysis of voluminous documentary materials. Frequently, the evidence necessary to obtain a conviction is buried within reams of financial and tax records to which law enforcement authorities have only limited access as a result of laws which focus on concepts of privacy, rather than specific criminal conduct.

The difficulty of conducting white-collar crime investigations is not limited simply to establishing what happened, because even when the overt facts are established, we need to reach beyond them to establish a criminal frame of mind.

For all these reasons, white-collar crimes are often difficult to detect and, when detected, are often difficult to prove beyond a reasonable doubt. As a result, white-collar crime poses special challenges to successful investigation and prosecution.

Let me turn to a brief description of the costs of white-collar crime.

In some senses, we have an ambivalent attitude that we need to address. It seems there are feelings in some quarters of society that this is a different and lesser order of criminality, and I think it is important in hearings like this that we strip away that false perception. White-collar crime is nothing less than crime itself.

The reality in terms of white-collar crime can be expressed in this fashion: It affects innocent people and innocent lives. There are personal victims and sometimes their lives are affected very directly and very tragically. I have a list of some such cases.

There are 100 elderly citizens in Florida who lost their life savings through a real estate scheme; farmers in the Midwest who, unable to obtain loans from local sources, sold their few remaining possessions to pay advance fees to con men who came through; hospital patients who, thanks to a diploma mill selling phony medical degrees, were left "brain dead" by a degree-buyer posing as an anesthesiologist; 200 young married couples in California who struggled to save their earnings and make down payments on homes, saw their savings disappear in a fraudulent scheme perpetrated by a State assistant attorney general; patients whose proper treatment for cancer and other diseases was delayed over a protracted period when they pinned their hopes on the efficacy of a "wonder machine" touted by a medical "quack."

We should keep in mind as we go through this that there are effects on individual victims. That gives us an opportunity to appreciate the real extent of the losses caused by white-collar crime, losses that frequently defy measurement in simple economic terms.

There have already been allusions to the difficulty of measuring white-collar crime. Let me make a quick comment in reference to measurements. We have some very sophisticated measurements in the criminal justice area now, such as the uniform crime reports and the crime surveys. They give us a good picture on the other areas of crime.

Ironically, two of our biggest problems, drug trafficking and white-collar crime, elude measurement, because we simply do not have the measurement tools. This is something that we might consider as we go through these hearings.

There have been projections. In 1982, a study funded by the accounting firm of Peat, Marwick & Mitchell, suggested the loss reached $200 billion a year. Dollar losses from Federal tax frauds are estimated by the Department of the Treasury to exceed $90 billion a year.

In one case, almost $700 million in losses to investors and ultimately to the Federal Government and thus to all taxpayers resulted from a Tennessee bank fraud scheme that led to a banker's entry of a plea of guilty and a 20-year sentence. The dimensions are very great. Although we look at crime rates in some sense as coming down, this is an intolerable level of crime that we face.

When I mentioned the bank fraud scheme, it illustrates one of the more pernicious and widespread consequences of white-collar crime. It causes failures of businesses, of savings and loan institutions and of banks. Fraud or other criminal conduct in fact was a factor in about half of the bank failures that occurred during the past 5 years. White-collar crime, therefore, carries unusually serious economic consequences for the well-being of our Nation.

In addition to personal victimization, in the aggregate it siphons billions of dollars a year from our economy. It adds to the costs of goods and services, subtracts from the revenues otherwise available to Federal and State treasuries, and it thereby aggravates the financial burdens of all Americans.

As noted, the financial losses caused by white-collar offenses reveal only the surface of the problem. Deeper effects are often severe. When a corrupt physician systematically falsifies treatment records, he erodes public confidence in the integrity of the entire Medicare Program. When a pharmacological distributor repackages and delivers outdated medications he endangers the health of innocent citizens. When a defense contractor substitutes substandard materials for parachutes he risks the lives of our servicemen.

To summarize, white-collar crime affects our economy, our lives. It is a particularly pernicious form of crime. It certainly warrants the attention of our investigators and prosecutors and the attention of this committee.

Let me give you some guiding principles then, which reflect the Department of Justice's approach to prosecution of white-collar crime.

At the outset, let me say this: It is our policy to prosecute significant white-collar crime cases to the utmost of our ability in accordance with existing law and available evidence, and to seek appropriate sanctions in all cases. We deviate from this policy only when we conclude, in the exercise of our professional judgment, in a particular case that doing so will enable us to achieve important law enforcement goals that otherwise might be unattainable.

The point is that we treat white-collar crime as we do all other crime. The most effective way of dealing with the majority of white-collar offenses is through the criminal justice process. However, there are other approaches and some of them ought to be born in mind.

Certainly the dominant one is the prosecution, conviction and imprisonment of all responsible individuals. That traditional solution in some instances does not go far enough. It sometimes ignores the need, in the special setting of offenses where we are involved with corporate violations, to impose direct and substantial sanctions upon the corporation in addition to those imposed on the individuals, and to force the corporation to adopt internal control mechanisms to prevent future criminal conduct and substantially to alter the ways in which the corporation conducts its affairs.

A related consideration, one that also tends to be overlooked in discussions of white-collar crime, is the general availability of noncriminal enforcement methods and the desirability in some cases of employing those methods instead of the criminal justice process. Many white-collar cases arise out of activities subject to Federal regulation and, consequently, to regulatory sanctions. Most such conduct is also subject to civil sanctions, such as damage awards, civil fines or penalties, and injunctions.

These various noncriminal sanctions can be tailored to provide appropriate redress, to remove the economic benefit derived from illegal activity, to restore the Treasury loss, and to prevent the continuation of unlawful practices. As a result, in certain instances

65-428 O - 87 - 2

their use can be as effective as resort to criminal penalties in achieving law enforcement goals.

Let me turn now to prosectorial policies. As I indicated, most of these cases deserve to be and are handled in the criminal process. White-collar crimes are prosecuted in accordance with the same principles that govern prosecution for other types of Federal offenses. We do not have a double standard.

The department has articulated and adopted what are called principles of Federal prosecution. These principles apply to violent offenses and white-collar offenses and they are applied equally across the board.

There is one dimension of white-collar crime already mentioned that complicates that process and that is that in many cases we must consider whether to charge only individuals or individuals and a corporation or only a corporation. In all such cases, we start with the fundamental proposition that a corporation can act only through individuals. It follows that individuals with requisite criminal intent to cause or permit a corporation to act in a manner that violates a criminal law should themselves be charged as criminals subject to criminal sanctions.

Our policy therefore is to prosecute the responsible corporate agents, particularly the senior officers, but also the lower-ranking employees to the extent permitted by law and the available evidence. This policy is carried out, except for the rare and unusual cases when it is superseded by other overriding law enforcement considerations.

We also believe that corporate prosecutions are necessary to an effective program of white-collar crime law enforcement. Such prosecutions can serve most of the purposes sought to be achieved by prosecution of individuals. Corporations can be made to suffer the stigma of criminal conviction as well as being punished through the imposition of substantial criminal fine and, as a collateral matter, being subjected to regulatory sanctions that are in many cases even more severe. Certainly, the sanction of debarring a corporation from defense contract work frequently can have an impact that no combination of individual prosecutions can achieve.

Corporation convictions can also help to ameliorate the losses of victims, either by furnishing a basis for orders of restitution against financially able defendants or by facilitating civil actions for damages. Corporate convictions can also stimulate shareholder pressure on management to operate lawfully.

The threat of these various consequences can act as an effective deterrent to corporate criminality. It is obvious that corporate officials, as others, have the natural desire to conduct their corporation's affairs within the bounds of the law, and most tend to engage in rational, cost-benefit analyses before taking action that could result in financial liability for themselves or their corporations.

Criminal convictions of corporations can also serve as the vehicles by which rehabilitation can be induced. On many occasions, convicted corporations have retained outside attorneys or accountants to review corporate policies and internal corporate procedures to determine how criminal behavior was permitted to occur, and to recommend measures to avoid repetition of the criminal conduct in the future.

We approach the question of whether a corporation should be indicted in the same manner as we do in cases involving only individuals. We reject any suggestion that a corporation should be treated leniently because of its artificial nature, or, conversely, that it should be subjected to increased exposure for that reason. Instead, we weigh all of the factors normally considered in the sound exercise of prosecutorial judgment.

On the aspect of the principles of prosecution, I would like——

Senator MCCONNELL. What page did you skip to?

Mr. JENSEN. Page 21, I skipped forward.

Senator MCCONNELL. Thanks.

Mr. JENSEN. Whenever we are considering any indictment of an individual or a corporation, we are bound by the available evidence and by our duty to exercise prosecutorial judgment responsibly.

As a matter of law, we may seek indictment only when the evidence establishes the existence of each element of the offense and the necessary mental state to establish that a person has committed an offense. As a matter of departmental policy grounded in fundamental considerations of prosecution responsibility, we adhere to an additional standard. We go forward with the prosecution only when we believe that the admissible evidence is of such convincing weight that it will persuade the reasonable factfinder that we have met our burden of proof such that the defendant will be convicted at trial. This policy is part of the Department's "Principles of Federal Prosecution" and applies not only in white-collar crime cases but in all Federal criminal cases.

The result of its application is that we do not subject people to criminal prosecution on the basis of supposition or even strong suspicion that they knew of or were involved in criminal activity. If the evidence is only marginal, the responsible exercise of discretionary authority requires that we forego prosecution. This does not mean, of course, that no official action will be taken. As already pointed out, there are a variety of civil or regulatory measures that can be employed in lieu of criminal proceedings, using a lesser burden of proof and we encourage their use in such instances.

There is a portion here on plea agreement policies. The point I make is that plea agreements are entered as a part of our professional judgment and according to the same principles. I would like to give some emphasis to our sentencing policies.

The seriousness with which we view white-collar crime is reflected not only in our approach to prosecution, but also in our policies and practices regarding sentencing in white-collar cases. Although sentencing in these cases, as in all Federal cases, is primarily the function and responsibility of the courts, we believe that Government attorneys have a critical role to play in the process, both in communicating relevant facts to the courts and in recommending appropriate sentences.

Because white-collar crimes are calculated and are economically motivated, we strongly believe that sentences in these cases have a particularly high deterrent impact. However, to achieve this effect—as well as to serve other purposes of criminal sanctions—they must adequately reflect the seriousness of the conduct involved.

White-collar offenses that involve traditional forms of criminality such as fraud, theft, or corruption, deserve to be treated severely, and the courts generally seem willing to impose appropriate prison sentences when they occur.

When other types of white collar crimes occur, unfortunately, there is sometimes a different view. When we deal with antitrust or environmental laws, for example, we sometimes see courts fashioning, in a sort of creative exercise, alternative sentences which involve contributions to charities or so-called community service. Imposition of such sentences on persons who deserve to go to prison—if only for a short term—does nothing to provide deterrence, and, repeated over time, diminishes the concept of justice.

Responsibility for this situation does not rest with the judiciary alone. I make the point that in 1984, in the Comprehensive Crime Control Act, Congress adopted a resolution expressing its view that imprisonment is generally inappropriate for a defendant who has not been convicted of "a crime of violence or otherwise serious offense."

Absent a clear understanding of what is meant by "serious," this resolution, which we strongly opposed at the time it was under consideration in the Senate and strongly disagree with today, can only reinforce a tolerant criminal justice system attitude toward white-collar crime.

Senator MCCONNELL. When did we pass that resolution?

Mr. JENSEN. This was in the 1984 legislation. It was a sense of the Senate resolution that was adopted. We opposed it then, as I say, and we oppose it now. We think it should be reconsidered and that you ought to look at it because it sends the wrong signal as far as we are concerned.

Senator METZENBAUM. On what basis did the department oppose it? I do not remember——

Mr. JENSEN. We sent letters. I would be happy to get you the letters, Senator Metzenbaum, which state our position on it.

Senator METZENBAUM. Did you send it to each member of the committee or——

Mr. JENSEN. I do not know how it was sent, but we communicated in a specific form, a written form by our——

Senator BIDEN. I take responsibility for both of us, Howard. I think they did send it to me.

Mr. JENSEN. Well, the point that I would like to make is we would like you to reconsider it, as a matter of fact.

Imprisonment is not the only appropriate sanction for white-collar offenses. Punishment and deterrence can also be achieved through the imposition of substantial fines. As a result of amendments contained in the Comprehensive Crime Control Act of 1984, it is now possible to impose appropriately severe monetary penalties on white-collar offenders, including fines of double the amount of gain or loss resulting from their crimes.

These provisions can be especially useful in removing the economic incentive to engage in white-collar crime, and they are absolutely necessary in fashioning appropriate sentences for corporate offenders who, of course, are not subject to imprisonment. Accordingly, it is our policy to recommend the imposition of substantial fines on all convicted corporations, as well as on individuals who

have the ability to pay, whether or not additional sanctions are urged.

From time to time, we also recommend or concur in the imposition of other kinds of sanctions in white-collar crime cases. For example, pursuant to the provisions of the Victim and Witness Protection Act of 1982, restitution is often recommended—ordinarily in addition to other sanctions.

In cases in which it appears that a prison term would not be appropriate or could not be imposed because the defendant is a corporation, we review the potential value of various conditions of probation. We recognize that, in rare instances, the use of carefully selected alternatives to traditional criminal sanctions can help to vindicate the interests of the criminal justice system and of society as a whole.

At the same time, however, we seriously doubt that any legitimate interest is served by such recent sentences as that which required an individual to organize a golf tournament as a fund raiser for charity, and that which required a corporation to endow a chair of ethics at a State university. We have given considerable attention to this matter of alternative sentencing over the past several months and we are now developing some guidelines on that subject for the use of our attorneys, and we can share them with you.

Now, let me turn to some specific management initiatives with reference to white-collar crime. It requires the commitment of a significant level of resources and it obviously needs a close attention from a management perspective.

The 1980 report of the Attorney General entitled "National Priorities for the Investigation and Prosecution of White-Collar Crime" included a master list of some 356 Federal white-collar offenses, a list that today would certainly approach 400. Plainly, it is beyond the capacity of the Federal Government regularly to enforce every statute against every violation. Just as plainly, any effort to do so would result in the expenditure of scarce resources on relatively less important offenses.

What is essential in this area therefore is a keen sense of priorities and maximum efficiency and productivity in the application of finite resources. Accordingly, we have adopted and have sought to institutionalize a number of management practices designed to focus our efforts more sharply; to develop close cooperation among the various Federal and State agencies involved in law enforcement, and between those agencies and the private sector; and generally to ensure the most effective use of the tools and resources available to us. As a result, we are addressing the problem of white-collar crime from a strategic perspective.

I mentioned before the Economic Crime Council. In 1983, the Attorney General created as a part of the Department of Justice an advisory body we call the Economic Crime Council. It is chaired by the Deputy Attorney General and its members include 22 U.S. attorneys as well as officials from the FBI and the Criminal, Antitrust, Civil, and Tax Divisions of the Department of Justice.

It has in its operation a working group which is chaired by the Assistant Attorney General for the Criminal Division and it is composed of experienced prosecutors from fraud units in the member U.S. attorneys' offices, which supports the council's activities. We

hold formal meetings at least twice a year, with the Attorney General directing and personally participating when he can.

The primary mission of the Council is to help identify, on a comprehensive basis, those kinds of economic crimes that are of national significance. Since, under our federal system, responsibility for prosecuting the majority of white-collar offenses lies with the States, the Federal Government must concentrate on cases that, for one reason or another, can be addressed best at the National level.

One of the Council's principal roles, therefore, has been to aid in focusing our attention on the most significant types of white-collar offenses within the Federal jurisdiction. Any of a number of factors may make a case significant for such purposes, but we place particular emphasis on identifying "cutting edge" prosecutions—those that will establish the illegality of a common practice and will, therefore, have a multiplier effect far beyond the outcome of individual cases.

Working with the Fraud Section of the Criminal Division, the Council has defined our white-collar crime law enforcement priorities. For the moment, we are concentrating on offenses that affect our national defense, our banking system, the taxpayers, and the investing public. We have six areas of priority—defense procurement fraud, fraud against banks and other financial institutions, money laundering, investment "boiler room" frauds, various types of securities fraud, and fraud by health care providers involving Medicare and Medicaid funds.

When nationally significant cases arise in these areas, it is the responsibility of the Council to advise departmental officials concerning the necessary allocation of investigative and prosecutorial resources to ensure an effective response.

We have also established, as I mentioned before, a Defense Procurement Fraud Unit. I know that you want to look at that specifically and so I will not go into that in any more specific detail, other than to say that we recognized back in 1981-82 the need to do this and to develop the expertise and the committed prosecutors and investigators to enable us to take on this particular responsibility of the Federal Government at a more effective and productive level.

We formed that unit in the Criminal Division and we have prosecutors in it from the Civil Divisions Fraud Section and we are planning to add lawyers from the Antitrust Division. We also have personnel from the FBI and the Department of Defense assigned to the Unit. As I say, we will be happy to make a much more specific presentation with reference to the Defense Procurement Fraud Unit that we have established.

In another area that might be called a cutting edge a kind of prosecution, we found that fraud against banks is a major concern. Half the bank failures in the United States, as I mentioned, were related to criminal conduct. That connection was deeply disturbing, for the Nation's economic health depends in large measure upon the stability of its banking institutions and the confidence with which the public views those institutions.

With that in mind, the Attorney General and the heads of the bank regulating agencies created a task force in late 1984 to revise the referral mechanisms that bring bank fraud cases into the

criminal justice system, and to develop better methods for handling the most significant of those cases.

The result of that effort is an interagency agreement that has improved our processing of major bank fraud cases and has strengthened the efficacy of enforcement mechanisms so that action can be taken to prevent bank failures.

We also have created an Environmental Crimes Unit within our Lands and Natural Resources Division and a parallel Criminal Enforcement Division was established in the EPA to do investigations. We will be happy to give a more specific presentation of that as we move into further hearings.

The point was made that we need to maintain the level of our attorneys' skills. One of our major efforts is one of continuing legal education. Since 1979, the Department has held 13 economic crime enforcement conferences at which senior assistant U.S. attorneys are provided with 3 days of concentrated instruction on effective white-collar crime prosecution techniques. These conferences are now sponsored by the Economic Crime Council and the Attorney General's Advocacy Institute. They bring together Federal prosecutors from around the country, permitting them to exchange information on approaches and problems, both practical and legal, as they relate to economic crime enforcement.

As another form of continuing legal education in the area of white-collar crime, the Council now publishes the Bulletin on Economic Crime Enforcement that covers current developments both in the law and in investigative techniques. It is distributed 6 times a year to over 1,000 Federal, State, and local prosecutors and investigators.

In 1981, we also established a fraud and corruption tracking system, the FACT system, to enable us to gather data on Government fraud as reported to the Department by the statutory inspectors general. This information is automatically matched with the U.S. attorneys case reporting system. By doing this we can track the investigations that have been referred to us and find their current status and their resolution. It enables us to see which of the agencies' programs are regularly subject to fraudulent activity, by whom, and to what degree of loss. The FACT system can be a very valuable tool and we are enhancing it as we go along.

As I mentioned before, there is an absolute need, whenever we view white-collar crime as a national phenomenon to realize that we must work with State and local investigators and prosecutors since they have much greater resources than the Federal system. We need to make that linkage.

We have established law enforcement coordinating committees in every U.S. attorney's office. The so-called LECC is an important factor as far as we are concerned in establishing complementary activities. One complementary activity that is particularly useful in the white-collar crime area is the concept of cross designation where State and local prosecutors, for example, are putting cases before Federal grand juries, and vice versa. Through this effort, we are able to increase our resources. In 1985, there were 239 cross designations in white-collar crime cases.

We also have at the national level, the Executive Working Group for Presidential Selection where we work with officials of the Na-

tional District Attorneys Association and the National Association of Attorneys General. We meet on a periodic basis with representatives of those organizations to consider and develop national policy level responses in the white-collar crime area.

As I mentioned before, our Antitrust Division works not only in the procurement fraud area but has devloped specific programs in collusive bidding. We can get to those in further testimony. The Lands Division has also moved into the environmental enforcement area in such fashion that I think we would also like to describe that in further hearings.

Let me move then to some statements about results. The available data in the Department's docket and reporting system—that is, in the U.S. attorneys' offices—covers white-collar crime offenses, but it does not cover environmental, tax, or antitrust offenses. I will mention those just briefly later.

The reporting system shows that prosecutions of white-collar crime offenses as a percentage of total Federal prosecutions rose from about 10 percent in the early seventies to about 20 percent in 1980 and thereafter. The average number of white-collar crime cases that we bring on an annual basis now is about 5,500. That is up slightly from a couple of years ago.

In the environmental enforcement area, which is separate, we had a 200-percent increase in the number of criminal prosecutions since the creation of the Environmental Crimes Unit I mentioned. More than 180 indictments have been obtained. We charged 130 individuals and 50 corporations and obtained more than 150 convictions in that area.

In criminal tax enforcement——

Senator BIDEN. Excuse me, Lowell, could I ask you a question about that statistic. It is up 200 percent since the creation of the Environmental Control Unit. Is it up from, say, 1979 200 percent? In other words, has there been a progression or——

Mr. JENSEN. Yes.

Senator BIDEN [continuing]. Are you measuring against yourself or are you measuring against the past is what I am saying?

Mr. JENSEN. We are measuring against the past and we are saying that the benchmark is when we put that unit in because that is when we saw an increase. I think we can describe it that way, but it is a measurement over time.

Senator BIDEN. I just wanted to get a sense of what it was.

Mr. JENSEN. Criminal tax cases are a terribly important program, given the numbers that I mentioned before. We have emphasized illegal tax shelters, tax protestors, and narcotic money laundering schemes.

There are increases there in statistics. Since 1981, the number of criminal tax cases brought annually increased from about 1,850 to over 2,450 now. The average annual number of cases during the past 5 years was close to 2,000 compared to about 1,600 for the previous 5 years.

In the antitrust field, we have initiated more than 400 criminal prosecutions in the past 5 years, more than double the number during the preceding 5-year period. We have won close to 90 percent.

In most of those cases, the targets have been horizontal restraints of trade, such as price fixing and market allocation. We have been particularly successful over the past several years in prosecuting bid rigging conspiracies in the field of public highway and airport construction, electrical contracting and utility construction. Over 60 percent of our 1985 criminal antitrust cases involved those industries. We have also brought many successful prosecutions affecting a wide variety of other goods and services.

The final result of this prosecution effort is reflected in the prison population. The number of fraud and tax offenders who have been imprisoned since 1980 has doubled. The figures were roughly 600 imprisoned persons in 1980 and about 1,300 now. We can give you specific data on that, but the fact is that there is a significant increase in the people who are going to prison as a result of white-collar crime prosecution.

We had a remarkable period, we believe, not so long ago. Last year, in a period of 70 days, this is what happened: The General Electric Co. was indicted and convicted in Philadelphia on charges of defrauding the Defense Department, and was simultaneously suspended from doing business with the U.S. Government. Two individual employees of General Electric were also indicted for perjury and obstructing justice, but were later acquitted at trial.

During the same time period, Jake Butcher entered guilty pleas to several indictments, and was sentenced to 20 years in prison for looting a series of banks in Tennessee and Kentucky. Two of his accomplices were also convicted and sentenced to prison.

During that same period of time, Paul Thayer, former Deputy Secretary of Defense and a Dallas stock broker, Billy Bob Harris, were sentenced in Washington, DC, to 4 years in prison for obstruction of justice in connection with roles in $1 million insider stock trading scheme.

During the same period of time, a 35-year prison term was imposed on Fred Soudan in Houston, TX, for his role in devising the largest maritime fraud in history, the sinking of the supertanker *Salem* off the West Coast of Africa.

In the same period of time, six defendants were convicted in Texas of Foreign Corrupt Practices Act violations in the $10 million Pemex/Crawford foreign bribery scheme.

During the same period of time, J. David Dominelli, in San Diego, was convicted on mail fraud charges in connection with defrauding 1,500 people out of some $200 million.

During the same period, the LeBlanc brothers were convicted in Detroit for an investment scheme in which 800 investors lost $10.5 million.

During the same period of time, convicted confidence man and boiler-room operator Jack Rose was indicted in Florida for perpetrating a precious metals scheme in which he defrauded 1,200 investors of $12 million.

During the same period of time, E.F. Hutton & Co., was convicted on a plea of guilty to 2,000 counts of mail and wire fraud, was enjoined from abusive cash management practices, and was compelled to set aside a minimum of $8 million for restitution in a complex "float" scheme.

That is a 70-day period. I think that describes as much as we can about the commitment of the Department and what is a significant achievement. I do not think there has been such a significant number of white-collar crime developments in such a short period of time in any other period of history.

There are a number of other cases that are referred to here. I will leave those references and also, as I say, they are in the compendium. We will also have some of those cases that will be subject to very specific hearings by this committee.

Now, I will finally make some references to measures which we believe are necessary to continued success in this area. It is essential to have a common understanding of the appropriate direction and intensity of future Federal law enforcement efforts against white-collar crime. These hearings provide us an ideal opportunity for reaching such an understanding, and indeed reaching a consensus.

What is required, we believe, is clear thinking, unencumbered by myths and misassumptions, on the part of all concerned, and a fair assessment of the record.

We recognize that we need to keep changing and keep adapting in this area. In terms of resources, white-collar crime law enforcement is, as we have noted, an inherently resource intensive undertaking. In fact, this area of law enforcement could easily consume a much larger proportion of the Department's investigative and prosecutorial resources were it not for our obligation to give appropriate emphasis to organized crime, drug trafficking, national security offenses and other serious forms of criminality.

It was this broader obligation that prompted the enlistment of the Federal Bureau of Investigation in the drug law enforcement effort a few years ago, an event that caused the bureau's investigative resources for white-collar crime to decline somewhat in a short time period.

We worked in subsequent budgets to restore agent strength in this regard to its former level. Although this situation was of concern, I think we have properly focused and increased total resources, we do not believe that, on balance, it has adversely affected our performance in this area.

The important point is that we must maintain at least the current level of general resources devoted to this aspect of Federal law enforcement. Doing so even in a time of unusual budget constraints should not be unduly burdensome. Investment in white-collar crime law enforcement is certainly a cost effective method of preventing and addressing the enormous drain on the Federal Treasury and the Nation's economy generally that would otherwise occur at the hands of white-collar criminals.

As I mentioned, we are interested in the development of other legal tools, more effective tools. We could go into these at further hearings. Some are already on the drawing board. One has already been mentioned and that is the money laundering bill. We would like to have an opportunity to work with you to see that we get some activity with reference to moving money laundering forward. We think that is a terribly important part of white-collar crime and other areas of criminal law enforcement.

We have an antifraud enforcement crime package. There are eight particular areas that are there and we would like also to work with you to move that forward.

We also have a very important bill that refers to the Federal Rules of Criminal Procedure that I think was alluded to. By decisions of the Supreme Court, rule 6(e), which applies to the grand jury process has been interpreted in such a fashion that it provides a direct problem for us in terms of flow of information to the civil attorneys in our Department of Justice. We find it extremely difficult to move information as we think it ought to be moved. We have proposed legislation to reform that particular area of the law and we think we can do so in such a fashion that we will not encourage abuses of the grand jury process or cavalier revelation of grand jury information, but we will be able to use the information that is generated in the grand jury to pursue fraud and misconduct through all of the rest of the remedies that have been enacted.

We think that these tools are extremely important and we look forward to working with you to form this legal context that can be of a great deal of assistance.

I will make quick mention of another area to which we have publicly alluded that was developed by the Economic Crime Council. We have on track the development of an economic crime index which will allow us to use technological facilities to put investigative efforts together. We will make it available to local law enforcement to track parallel and overlapping kinds of criminal efforts and to get at the confidence men that plague this country.

A final word on sentencing. In creating the U.S. Sentencing Commission, Congress recognized the necessity for reform of Federal sentencing practices and procedures. We are hopeful that the Commission's work will provide the specific sentencing guidance that is needed, particularly in the white-collar crime area. To help make that hope a reality, we have assigned various components of the Department to the specific task of assisting the Commission in its efforts to develop white-collar crime sentencing policies and guidelines.

Apropos of that, I would like you to reconsider the sense of the Senate measure that I mentioned before. We need to move forward in the sentencing area.

Finally, as a general matter, all of us must realize there are limits to what the criminal process can do. We must recognize the potential contribution to effective enforcement of other mechanisms for securing compliance with the law, particularly civil and regulatory sanctions. We must also encourage the business community to be alert to behavior that borders on illegality, since often what is needed is a heightened sense of moral responsibility and sensitivity in the conduct of economic affairs.

As I mentioned at the outset of this statement, we welcome the opportunity these hearings provide to inform members of the committee and others in Congress of our philosophical and practical approaches to the challenge of white-collar crime. We think there is a record of solid achievement, yet we realize that there is more to be accomplished.

We invite the constructive participation of Congress: indeed we welcome it in the exercise of your legislative and oversight respon-

sibilities, in forging an even more effective program to protect the Nation and its citizens from the consequences of serious white-collar crime.

Thank you.

[The complete statement of Mr. Jensen follows:]

STATEMENT

OF

D. LOWELL JENSEN
DEPUTY ATTORNEY GENERAL

## II. THE PROBLEM OF WHITE COLLAR CRIME

### A. The Nature of White Collar Crime

White collar crime is an insidious form of criminality, and so serious and pervasive a threat to the Nation's well-being that it requires a high degree of attention at the federal level. By "white collar crime," we generally mean to denote a broad range of non-violent criminal activity that either threatens or injures important governmental, economic, or social interests. Those interests include: the integrity and effectiveness of government institutions, processes, and programs; the economic well-being of business enterprises, consumers, investors, and employees; and the physical health and safety of the general public. Thus, we use the term "white collar crime" to encompass such offenses as bribery and corruption of officials at all levels of government; procurement fraud; tax fraud and fraud against government programs; bank fraud and embezzlement; consumer fraud and antitrust violations; securities, commodities, and other investment fraud; misuse of union funds and labor bribery; and environmental crimes and food and drug law violations.

Invariably, white collar offenses are motivated by a desire for economic gain or advantage. They are usually carefully calculated. They are also commonly carried out surreptitiously -- by deceit, concealment, or breach of trust -- beneath a veneer of legitimacy and respectability. That veneer may be furnished by membership in a generally reputable profession, or by operation through an otherwise legitimate corporation or other organizational entity.

These and other aspects of white collar offenses make them extraordinarily difficult to investigate successfully. Unlike so-called "street crimes" and other violent offenses, white collar crimes frequently are not self-evident. Due to the use of subterfuge and concealment -- usually involving deception, record manipulation, and cover-up -- often not even the victims realize that they have been defrauded until long after the event. Even then, investigators must painstakingly work their way through complex "paper trails" before they can determine whether the law was violated, whether the violation was criminal, and who was responsible.

In addition, the perpetrators of white collar crime are frequently sophisticated in business matters, and able to exploit the complexities of modern accounting and banking techniques to obfuscate their actions and to confuse those who might attempt to uncover them. They are quick to employ the latest advances in supporting technology, particularly the use of computers. Moreover, they often design their enterprises to take advantage of limited jurisdictional boundaries by which law enforcement agencies are necessarily constrained, thus working, for example, in one location, while their victims may be in another city, another state, or even another nation. Convicted offenders in fact have acknowledged that they deliberately set up operations in areas distant from their victims in order to disrupt the normal investigative process that operates most effectively when the offender and the victim are within the same jurisdiction.

Another serious impediment to successful investigation relates to the fact that these are usually "paper" cases -- cases requiring access to, and painstaking analysis of, voluminous documentary materials. Frequently, the evidence necessary to obtain convictions is buried within reams of financial and tax records, to which law enforcement authorities have only limited access as a result of laws passed by Congress with an eye not on crime, but on generalized concepts of privacy.

The difficulty of conducting white collar crime investigations is not limited simply to establishing what happened. Even when the overt facts can be proved -- for example, the making of false statements or the occurence of questionable financial transactions -- those facts alone rarely provide sufficient evidence of the specific intent required -- fraudulent or corrupt -- to obtain a conviction. In such cases, it is often essential to secure the testimony of another participant in the offense, but cooperation ordinarily is not forthcoming without some concession by the government, such as a reduction in the number of the charges, a reduction in the gravity of the charges, or a favorable recommendation at the time of sentencing, or without a compulsion of testimony through a court order which by law precludes use of the testimony against the testifying witness.

For all of these reasons, white collar crimes are often difficult to detect and, when detected, are often difficult to prove beyond a reasonable doubt. As a result, white collar crime poses special challenges to successful investigation and prosecution.

B. The Costs of White Collar Crime

Another important aspect of white collar crime, and one that is particularly disturbing, is the ambivalent attitude it seems to generate in some quarters of our society. We often confront a tendency to dismiss economic and other white collar offenses as some lesser form of criminality. When the subject is treated in our fiction, we commonly find the perpetrator portrayed as an inventive, glamorous figure who steals only from the dishonest, the rich, or the greedy. When the subject is touched upon in more serious discussions, it tends to be approached from the opposite direction -- in terms of abstract concepts and

statistics only distantly related to the lives of individual citizens.

The reality is, of course, quite different. White collar crime affects innocent people who frequently can ill afford to bear the loss, and whose lives are sometimes altered very directly and very tragically. Among the true victims are:

- the 100 elderly citizens in Florida who lost their life savings through a retirement village real estate scheme, half of whom also lost their self- sufficiency as a consequence and were made destitute;

- farmers in the Midwest who, unable to obtain loans from local sources, sold their few remaining possessions to pay an advance fee to an out-of-town confidence man in a last ditch effort to save their farms;

- the hospital patient who, thanks to a diploma mill that sold phony medical degrees, was left "brain dead" by a degree-buyer posing as an anesthesiologist;

- the 200 young married couples in California who, having struggled to save enough from their earnings to make the down payment on a home, saw their savings disappear in a fraudulent scheme perpetrated by a State assistant attorney general.

- the patients whose proper treatment for cancer and other diseases was delayed for a protracted period while they pinned their hopes on the efficacy of a "wonder machine" touted by a medical "quack."

It is only by keeping in mind the effects on individual victims that we can begin to appreciate the real extent of the losses caused by white collar crime -- losses that frequently defy measurement in simple economic terms.

Even when viewed in abstract economic terms -- dollar amounts -- the direct loss caused by white collar crime is staggering. While we have no fully satisfactory estimates on the extent of white collar crime, and while statistical reports vary, all estimates indicate a tremendous loss. For example, in 1974, the National Chamber of Commerce estimated the annual loss through white collar crime at $40 billion. In 1982, a study funded by the accounting firm of Peat, Marwick, and Mitchell suggested that the loss had ballooned to $200 billion. Dollar losses from federal tax frauds are estimated by the Department of the Treasury to exceed 90 billion. Over $100 million is lost annually through "boiler room" operations selling commodities such as precious metals by telephone. Over $100 million per year, in each of the last five years, has been lost in real estate investment schemes in California alone. Hundreds of millions of dollars have been lost by tens of thousands of investors who have been victimized by fraudulent financial service brokers operating in Florida, California, Utah, Ohio, and New Hampshire. About $80 million was lost in a single investment fraud scheme on the West Coast, the perpetrator of which we prosecuted successfully last year. Almost $700 million in losses to investors, and ultimately to the federal government and thus to all taxpayers, resulted from a Tennessee bank fraud scheme that led to a banker's entry of a plea of guilty, and 20-year prison sentence, in 1985.

This latter case illustrates one of the more pernicious and widespread consequences of white collar crime -- it causes failures of businesses, of savings and loan institutions, of banks. Fraud or other criminal conduct in fact was a factor in about half of the bank failures that occurred during the past five years.

White collar crime, therefore, carries unusually serious economic consequences for the well-being of our Nation. It siphons billions of dollars a year from our economy. It adds to the costs of goods and services, and substracts from the revenues otherwise available to the federal and state treasuries, thereby aggravating the financial burdens of all Americans.

As noted earlier, though, the financial losses caused by white collar offenses reveal only the surface of the problem. The deeper effects are often severe. When a corrupt physician systematically falsifies treatment records he erodes public confidence in the integrity of the entire Medicare program. When a pharmacological distributor repackages and delivers outdated medications he endangers the health of innumerable innocent citizens. When a defense contractor substitutes substandard materials for parachutes he risks the lives of our servicemen.

To summarize, white collar crime affects our economy and our lives. It is a particularly pernicious form of crime. It warrants the concentrated attention of our investigators and our prosecutors.

## III. GUIDING PRINCIPLES

### A. General Considerations

I will discuss in a moment some of the specific principles that guide our white collar crime law enforcement efforts, but I want to be sure that one point is clearly understood at the outset. It is our policy to prosecute significant white collar crime cases to the utmost of our ability in accordance with existing law and available evidence, and to seek appropriate sanctions -- including federal prison sentences unless plainly not warranted -- in all cases. We deviate from this policy only when we conclude, in the exercise of our professional judgment, that doing so will enable us to achieve important law enforcement goals that might otherwise be unattainable.

In this connection, it is important to recognize that traditional responses to crime are not the only responses available in cases of white collar crime, nor are they always the best responses. Let me explain.

The most effective way of dealing with the majority of white collar offenses is through the criminal justice process. Even so, there are a number of approaches to a successful criminal enforcement effort. Certainly the dominant one is the prosecution, conviction, and imprisonment of all responsible individuals. But that traditional solution, in many instances, does not go far enough. It does not directly take into account the need to prevent crimes before they occur, or to bring cases that by their scope and the swiftness by which they become final, provide clear, dramatic warning that specific conduct will be prosecuted. It also ignores the need, in the special setting of offenses committed to benefit corporations, to impose direct and substantial sanctions upon the corporation, in addition to those imposed on the individuals, and to force the corporation to adopt internal control mechanisms to prevent future criminal conduct and substantially to alter the ways in which the corporation conducts its affairs.

A related consideration -- one that also tends to be overlooked in discussions of white collar crime law enforcement -- is the general availability of non-criminal enforcement methods and the desirability in some cases of employing those methods instead of the criminal justice process. Many white collar crimes arise out of activities subject to federal regulation and, consequently, to regulatory sanctions. Most such conduct is also subject to civil sanctions, such as damage awards, civil fines or penalties, and injunctions. These various non-criminal sanctions can be tailored to provide appropriate redress, to remove the economic benefit derived from illegal activity, and to prevent the continuation of unlawful practices. As a result, in certain instances their use can be as effective

as resort to criminal penalties in achieving law enforcement goals.

In some cases, use of one or another of these non-criminal approaches may be the only course available, or may for valid reasons be considered preferable to reliance on the criminal process. Certainly we cannot proceed with a criminal prosecution when, for example, the conduct involved lacks the element of moral culpability necessary for a criminal conviction, or when the likelihood of obtaining a conviction is seriously cast in doubt by the equivocal nature of the evidence of criminal intent. Before proceeding with a white collar crime prosecution, the attorney for the government, as in any other kind of criminal case, must be satisfied that the threshold standards have been met to warrent initiation of the criminal process -- satisfied that the admissible evidence is sufficient to establish every element of the offense beyond a reasonable doubt. Even in some cases in which the threshold standards are met, however, non-criminal approaches may be found preferable, as, for example, when resort to the criminal process would unduly delay an urgently needed determination that a particular practice is unlawful, or when criminal prosecution would not be considered cost-effective in light of the sentence that the court can be expected to impose.

B. Prosecutorial Policies

Notwithstanding the broad range of options available for dealing with white collar crimes, the fact is that most of these cases deserve to be, and are, handled criminally. Thus, it is important to understand the principles of prosecution that we follow in those cases.

As a general rule, white collar crime cases are prosecuted in accordance with the same principles that govern prosecutions for other types of federal offenses. There is no "double standard"

under which white collar offenses are prosecuted less vigorously than other crimes, nor do white collar offenders otherwise receive preferential treatment by federal prosecutors. The Department's "Principles of Federal Prosecution" extend equally to violent offenses and white collar offenses, and they are applied equally.

There is, however, one dimension of white collar crime that frequently complicates the prosecutorial decision-making process. I refer to the problem of determining who should be held responsible when the offense was committed by or through a corporation. In such cases, we must consider whether to charge only the individuals involved, both the individuals and the corporation, or only the corporation.

In all such cases, we start with the fundamental proposition that a corporation can act only through individuals. It follows that individuals who, with requisite criminal intent, cause or permit a corporation to act in a manner that violates the criminal law should themselves be charged as criminals and subjected to criminal sanctions. Our policy, therefore, is to prosecute the responsible corporate agents -- particularly the senior officers but also the lower ranking employees -- to the extent permitted by the law and the available evidence. This policy is carried out except when, in rare and unusual cases, it is superseded by other, overriding law enforcement considerations.

We also believe that corporate prosecutions are necessary to an effective program of white collar crime law enforcement. Such prosecutions can serve most of the purposes sought to be achieved by prosecutions of individuals. Corporations can be made to suffer the stigma of criminal convictions, as well as being punished through the imposition of substantial criminal fines and -- as a collateral matter -- being subjected to regulatory sanctions that are in many cases even more severe; certainly the sanction of debarring a corporation from defense contract work

frequently can have an impact that no combination of individual prosecutions can achieve. Corporate convictions can also help to ameliorate the losses of victims, either by furnishing a basis for orders of restitution against financially able defendants, or by facilitating civil actions for damages. Corporate convictions can also stimulate shareholder pressure on management to operate lawfully. The threat of these various consequences can act as an effective deterrent to corporate criminality. Most businessmen have a natural desire to conduct their corporation's affairs within the bounds of the law, and most tend to engage in rational, cost-benefit analyses before taking action that could result in financial liability for themselves or their corporations.

Criminal convictions of corporations can also serve as the vehicles by which rehabilitation can be induced. On many occasions, convicted corporations have retained outside attorneys or accountants to review corporate policies and internal control procedures to determine how criminal behavior was permitted to occur, and to recommend measures to avoid repetition of the criminal conduct in the future. Moreover, as the recent E. F. Hutton case demonstrated, prosecution of a single corporation can serve notice throughout an industry of the criminality of a previously accepted business practice, thereby, in effect, reforming an entire segment of the corporate community. We believe we are beginning to see a similar change in the attitudes and conduct of major defense contractors as a result of recent procurement fraud prosecutions.

We approach the question whether a corporation should be indicted in the same manner as we do in cases involving only individuals. We reject any suggestion that a corporation should be treated leniently because of its artificial nature, or, conversely, that it should be subjected to increased exposure for that reason. Instead, we weigh all of the factors normally considered in the sound exercise of prosecutorial judgment,

including sufficiency of the evidence; likelihood of success at trial; probable deterrent, rehabilitative, and other consequences of conviction; and adequacy of non-criminal approaches. However, because of the unusual nature of crimes involving corporations, two additional questions must be resolved before a decision is made to seek to indict a corporation.

First, there is the question whether the offense was committed for a corporate motive, usually an economic one, or whether the corporation, although technically in violation of the law, was merely a device for committing an offense designed to benefit the responsible officers and employees. The latter situation might arise, for example, in a stock manipulation case where a corporation issued false statements inducing investors to buy its securities, but where in fact the promotion was designed from the outset to enrich the corporate principals. By contrast, many instances of fraud against the government are committed for a corporate motive -- the responsible corporate officials create false records and make false claims primarily for the benefit of the corporation; any gains realized by the individuals are at best indirect.

The second question, equally important, is whether the corporation -- particularly a closely held corporation -- has an existence that is truly separate from the individuals who directed the offense. It is common in virtually every kind of white collar crime to find individual criminals who create and use corporate vehicles to perpetrate their swindles. In numerous cases, the corporate entity simply stops doing business when the fraud is disclosed and the responsible individuals are charged. In such cases, the considerations that support corporate prosecution generally are not present, and there is, therefore, little reason to name the corporation as a defendant in the criminal case. Conversely, when the corporation involved in the offense is expected to continue its operations as a substantial member of the business community, serious consideration must be given to including it as a defendant.

As a matter of general policy, we expect that when an offense is discovered that leads to indictment of a corporation, the responsible individuals can and will be charged as well. The cases where only a corporation is charged are, and will continue to be, few and exceptional. There are, however, unusual factors that can make it appropriate to name only the corporation, and not the responsible officials.

It may be appropriate to charge the corporation alone when the responsible corporate officials acted through mistake or ignorance of the law. This is more likely to be the case when the offense is in violation of a regulatory proscription. Under these circumstances, it may be possible to prove criminal intent on the part of the corporation by attributing it to the sum total of the knowledge of its agents, even though it could not be proved that any single agent had the state of mind necessary to support a conviction. This was the situation in the prosecution of the Bank of Boston for violating the currency transactions reporting requirements.

Another circumstance supporting indictment of a corporation, without accompanying charges against responsible officials, occurs when there is a genuine legal question whether the underlying conduct violates the criminal law, or can be addressed only by civil or regulatory remedies. When the government is confronted by conduct that lies near an undefined edge of the criminal law, basic considerations of fairness counsel against imposing the severe consequences of conviction on individuals who may honestly have believed that their conduct, although perhaps a questionable business practice, was not criminal. These considerations may not weigh as heavily in cases of corporate wrongdoing, since imprisonment is not a possible consequence of conviction. A situation of this kind arose most recently in the E. F. Hutton prosecution, where existing case law created a genuine question whether the cash management practices utilized by Hutton could be reached by federal criminal law. It was also

present in many of the overseas bribery cases. In such situations, prosecution of the corporation rather than its individual agents alerts the business community at large to the fact that the underlying conduct is, in fact, criminal, and clarifies the law for purposes of future prosecutions of individuals as well as corporations.

By stating that prosecution of a corporation can be used to clarify the reach of the criminal law, we do not mean to imply that prosecution of a corporation is somehow a lesser remedy than prosecution of individuals, or that the standards for indicting a corporation are less stringent. In effect, that would suggest that prosecution of corporations is in some way more civil than criminal in nature, a concept with which we would strongly disagree. We do not intend to use corporate prosecution as a substitute for civil or regulatory action. Corporate prosecution is an integral part of our arsenal of weapons against white collar crime. It is a serious matter with substantial consequences to the officers, directors, employees, and owners of the corporate defendant, and it is not an action that we undertake lightly.

One additional aspect of our prosecution policy deserves emphasis. Whether we are considering the indictment of an individual or a corporation, we are bound by the available evidence and by our duty to exercise prosecutorial judgment responsibly. As a matter of law, we may seek an indictment only when the evidence establishes probable cause to believe a person has committed an offense. As a matter of Departmental policy -- grounded in considerations of fairness and based on the need to use our resources most efficiently -- we adhere to a higher standard: we go forward with a prosecution only when we believe that the law and the evidence are such that the defendant probably will be convicted at trial. This policy is articulated in Part B(2) of the Department's "Principles of Federal Prosecution," and applies not only in white collar crime cases, but in all federal criminal cases. The result of its application

is that we do not subject people to criminal prosecution on the basis of supposition or even strong suspicion that they knew of or were involved in criminal activity. If the evidence is only marginal, the responsible exercise of our discretionary authority requires that we forego prosecution. This does not mean, of course, that no official action will be taken, for -- as already pointed out -- there are a variety of civil and regulatory measures that can be employed in lieu of criminal proceedings, and we encourage their use in such instances.

C. Plea Agreement Policies

The Department considers possible plea agreements in white collar crime cases in the same manner as it considers like dispositions in other kinds of prosecutions. In no case do we enter into a plea agreement unless we are satisfied that the charges to which the defendant proposes to plead guilty fairly reflect the nature and scope of his criminal activity and provide the basis for imposition of an appropriate sentence under all the circumstances of the case. Direction to this effect appears in the Department's "Principles of Federal Prosecution" in Part D(3). In determining whether the ends of justice will be served adequately by the proposed agreement, we evaluate all relevant considerations, including weight of the evidence, likelihood of conviction, and probable sentence or other consequences of conviction. Some of the relevant factors may, however, have more weight in the context of white collar crime prosecutions than in other situations.

For example, the defendant's willingness to cooperate in the investigation or prosecution of others may be particularly significant in view of the difficulty of proving white collar offenses without testimony by an "insider." So too, the risk of losing at trial may appear greater in a complex white collar crime case, particularly one involving the use of a novel legal theory as was involved in the Hutton prosecution, than in other kinds of cases where the facts are relatively simple and the

legal principles well established. Another factor that frequently has greater weight in white collar crime prosecutions is the need for prompt and certain disposition of the case. Because these prosecutions tend to be very complex and resource-intensive, a prompt yet favorable outcome can effect a considerable saving of time and effort that can then be diverted to the prosecution of other cases. In addition, a prompt disposition may be particularly desirable to bring an immediate end to widespread illegal practices, as was the case in the Hutton situation.

D. Sentencing Policies

The seriousness with which we view white collar crime is reflected not only in our approach to prosecution, but also in our policies and practices regarding sentencing in white collar cases. Although sentencing in these cases -- as in all federal cases -- is primarily the function and responsibility of the courts, we believe that government attorneys have a critical role to play in the process, both in communicating relevant facts to the courts and in recommending appropriate sentences.

Because white collar crimes are calculated and are economically motivated, we strongly believe that sentences in these cases have a particularly high deterrent impact. However, to achieve this effect -- as well as to serve other purposes of criminal sanctions -- they must adequately reflect the seriousness of the conduct involved.

White collar offenses that involve traditional forms of criminality such as fraud, theft, or corruption, deserve to be treated severely, and the courts generally seem willing to impose appropriate prison sentences in such cases. However, when other types of white collar crimes occur, such as criminal violations of the antitrust or environmental laws, a different view frequently seems to prevail. In these cases, not only are there no grisly crime scene photographs, no battered victims, and no

drugs or weapons, but often no direct taking of property. A defendant in such a case -- often a prominent member of the community -- may not seem on the surface to pose much of a danger to society. As a result, after defense argument that the loss of reputation, perhaps coupled with some economic deprivation and probationary requirements, is punishment enough, we sometimes see courts engaging in the "creative" exercise of fashioning "alternative sentences" involving contributions to charities or so-called "community service." The imposition of such sentences on persons who deserve to go to prison -- if only for a short term -- does nothing to provide deterrence, and, repeated over time, makes a mockery of the concept of justice. Responsibility for this situation does not rest with the judiciary alone, for in 1984 -- in Section 239 of the Comprehensive Crime Control Act -- Congress adopted a resolution expressing its view that imprisonment is generally inappropriate for a defendant who has not been convicted of "a crime of violence or otherwise serious offense." Absent a clear understanding of what is meant by "serious," this resolution, which we strongly opposed at the time it was under consideration in the Senate and strongly disagree with today, can only reinforce the tolerant attitude of some sentencing judges towards white collar crime. We attempt to counter such ill-advised trivialization of the criminal process in our presentence presentations and recommendations, but our views -- weighed against the Congressional resolution -- are ignored with discouraging frequency.

To be sure, imprisonment is not the only appropriate sanction for white collar offenses. Punishment and deterrence can also be achieved through the imposition of substantial fines. As a result of amendments contained in the Comprehensive Crime Control Act of 1984, it is now possible to impose appropriately severe monetary penalties on white collar offenders, including fines of double the amount of gain or loss resulting from their crimes. These provisions can be especially useful in removing the economic incentive to engage in white collar crime, and they are absolutely necessary in fashioning appropriate sentences for

corporate offenders who, of course, are not subject to imprisonment. Accordingly, it is our policy to recommend the imposition of substantial fines on all convicted corporations, as well as on individuals who have the ability to pay, whether or not additional sanctions are urged.

From time to time, we also recommend or concur in the imposition of other kinds of sanctions in white collar crime cases. For example, pursuant to the provisions of the Victim and Witness Protection Act of 1982, restitution is recommended -- ordinarily, in addition to other sanctions -- whenever the defendant appears to have the means with which to recompense his victims. In cases in which it appears that a prison term would not be appropriate, or could not be imposed because the defendant is a corporation, we review the potential value of various conditions of probation. We recognize that, in rare instances, the use of carefully selected alternatives to traditional criminal sanctions can help to vindicate the interests of the criminal justice system and of society as a whole. At the same time, however, we seriously doubt that any legitimate interest is served by such recent sentences as that which required an individual to organize a golf tournament as a fund-raiser for charity, and that which required a corporation to endow a chair of ethics at a state university. We have given considerable attention to this matter of "alternative sentencing" over the past several months, and we are now developing guidelines on the subject for use by attorneys for the government during the sentencing process.

## IV. MANAGEMENT INITIATIVES

Since white collar crime is a particularly serious and widespread problem, and since its successful investigation and prosecution requires the commitment of a high level of resources,

any considered federal program to reduce its impact must be more centrally developed and more closely governed than is common for most other kinds of federal cases. This is particularly true in light of the number of federal statutes covering white collar crime, and the high volume of cases under many of these statutes. A 1980 Report of the Attorney General entitled "National Priorities for the Investigation and Prosecution of White Collar Crime" included a "master list" of some 356 federal white collar offenses -- a list that today would certainly approach 400. Plainly, it is beyond the capacity of the federal government regularly to enforce all of these statutes against all violators. Just as plainly, any effort to do so would result in the expenditure of scarce resources on relatively less important offenses to the detriment of more significant cases. What is essential in this area, therefore, is a keen sense of priorities and maximum efficiency and productivity in the application of finite resources. Accordingly, we have adopted, and have sought to institutionalize, a number of management practices designed to focus our efforts more sharply; to develop close cooperation among the various federal and state agencies involved in law enforcement, and between those agencies and the private sector; and generally to ensure the most effective use of the tools and resources available to us. As a result, we are addressing the problem of white collar crime from a strategic perspective.

A. The Economic Crime Council

In 1983, the Economic Crime Council was created by the Attorney General to serve as an advisory body on white collar crime law enforcement policy within the Department of Justice. The Council is chaired by the Deputy Attorney General. Its members include 21 United States Attorneys as well as officials from the Federal Bureau of Investigation and the Criminal, Antitrust, Civil, and Tax Divisions. Attached to the Council are broad-based working groups, composed of experienced prosecutors, that provide support for the Council's activities. Formal meetings of the Council are held at least twice a year, sometimes with the Attorney General's personal participation.

The primary mission of the Economic Crime Council is to help identify for prosecution, on an expedited basis, those kinds of economic crimes that are of national significance. Since, under our federal system, responsibility for prosecuting the majority of white collar offenses lies with the states, the federal government must concentrate on cases that, for one reason or another, can be addressed best at the national level.

One of the Council's principal roles, therefore, has been to aid in focusing our attention on the most significant types of white collar offenses within the federal jurisdiction. Any of a number of factors may make a case significant for such purposes, but we place particular emphasis on identifying "cutting edge" prosecutions -- those that can establish the illegality of a common practice and that will, therefore, have a multiplier effect far beyond the outcome of the individual case.

Working with the Criminal Division, the Council has defined our white collar crime law enforcement priorities. We are concentrating on offenses that affect our national defense, our banking system, the taxpayers, and the investing public. Thus, our six areas of priority are defense procurement frauds, frauds against banks and other financial institutions, money laundering, investment "boiler room" frauds, various types of securities frauds, and health care frauds involving Medicare and Medicaid. When nationally significant cases arise in these areas, it is the responsibility of the Council to advise Departmental officials concerning the necessary allocation of investigative and prosecutorial resources to ensure an effective response.

B. The Defense Procurement Fraud Unit

Three years ago, the Department of Justice initiated a concentrated effort in partnership with the Department of Defense to uncover and prosecute criminal activity associated with defense procurement. The setting in which that effort began

posed a number of problems. Extensive and time consuming internal Department of Defense procedures slowed the referral of contract fraud allegations. Once referred, there was a lack of coordination between Defense Department investigators and Justice Department prosecutors, making it difficult to develop contract fraud prosecutions in a timely fashion. There was also a lack of enthusiasm; overworked United States Attorneys were reluctant to commit prosecutorial resources to defense procurement cases, since even experienced prosecutors perceived these cases to be very complex, time consuming, lacking in jury appeal, and likely to result in a sentence insufficient to serve the public interest and to justify the time and effort expended.

The Defense Procurement Fraud Unit was formed in the fall of 1982, as an integral part of the Criminal Division's Fraud Section, to help provide a solution to many of these problems. The Unit brings together prosecutors from the Department of Justice with personnel from the FBI and from the Department of Defense, and frees them to concentrate solely on defense procurement fraud cases. The Unit has four major responsibilities. First, it establishes and coordinates policy and enforcement priorities in the defense procurement fraud area. Second, it screens defense procurement fraud cases to identify and focus resources on those with important prosecutive potential merit. Third, it directly investigates and prosecutes some of the more nationally significant cases. Fourth, it provides advice, guidance, and staff support to United States Attorneys' offices and others in cases it does not undertake directly.

The Unit has made a significant difference in the handling of defense procurement fraud cases, particularly accounting fraud cases. It has also helped to encourage United States Attorneys throughout the country to focus on procurement fraud cases as high priority matters. In addition, it has been instrumental in training investigators and Assistant United States Attorneys, it has assisted materially in establishing lines of communication

between United States Attorneys' offices and components of the Defense Department, and, by its regular provision of technical advice to prosecutors across the country, it has improved the quality and quantity of the cases prosecuted.

C. The Interagency Agreement on Bank Fraud Cases

The Department has also made significant improvements in the handling of bank fraud prosecutions. Fraud against banks is of major concern for one simple reason -- over half of the bank failures in the United States in recent years were either caused by, or were related to, criminal conduct. That connection is deeply disturbing, for the Nation's economic health depends in large measure upon the stability of its banking institutions and the confidence with which the public views those institutions. With that in mind, the Attorney General and the heads of the bank regulating agencies created a task force in late 1984 to revise the referral mechanisms that bring bank fraud cases into the criminal justice system, and to develop better methods for handling the most significant of those cases. The result of that effort is an interagency agreement that has improved our processing of major bank fraud cases, and has strengthened the efficacy of enforcement mechanisms so that action can be taken to prevent bank failures.

D. The Environmental Crimes Unit

Violations of environmental laws not only risk severe harm to our national resources, they frequently threaten the health and safety of the public. Accordingly, they warrant swift and certain prosecution. To that end, the Department's Land and Natural Resources Division has developed a coordinated program to investigate and prosecute environmental crimes, particularly those involving intentional, clear, and harmful violations of the environmental statutes. In 1982, the Division established an Environmental Crimes Unit to focus the government's prosecutorial resources on this specialized field. This initiative was

complemented by the simultaneous creation, within the Environmental Protection Agency, of a Criminal Enforcement Division, and the hiring by that agency of criminal investigators to prepare cases for referral to the Department.

Since its inception, the Environmental Crimes Unit has concentrated on cases involving a clear, knowing disregard of the law that causes actual or imminent harm to individuals. These cases include those involving conduct that takes place outside the regulatory scheme -- as in the situation of a generator of hazardous wastes who, having never applied for a permit to dispose of toxic materials, dumps them along roadsides or near residential areas, thereby endangering the public -- and those involving conduct that takes place within the regulatory scheme -- for example, the filing of false reports to conceal unlawful activity. In all such cases, as in other corporate prosecutions, a central goal is to establish the accountability of the highest ranking corporate official responsible for the offense.

E. Other Initiatives

There are several other administrative steps we have taken to improve our ability to respond to white collar crime. Among them are the following.

Since 1979, the Department has held 13 semi-annual Economic Crime Enforcement Conferences at which senior Assistant United States Attorneys are provided with three days of concentrated instruction on effective white collar crime prosecution techniques. The conferences are now sponsored by the Economic Crime Council and the Attorney General's Advocacy Institute. They bring together experienced federal prosecutors from around the country, permitting them to exchange information on approaches and problems, both practical and legal, as they relate to economic crime enforcement. As another form of continuing legal education in the area of white collar crime, the Council now

publishes the Bulletin on Economic Crime Enforcement that covers current developments both in the law and in investigative techniques; it is distributed six times a year to over 1,000 federal, state, and local prosecutors and investigators.

In 1981, the Department's Criminal Division designed, and later implemented, a Fraud and Corruption Tracking (FACT) system to collect important statistical information on fraud against the government, official corruption, and theft of government property, as reported by the statutory Inspectors General to the Department. The reported information is automatically matched with the information in the U. S. Attorneys' case reporting system. This matching of investigations with prosecutions provides the agencies with current status reports on the matters they forward to the Department. It also enables the Department to see which of the agencies' programs are regularly the subject of fraudulent activity, by whom, and to what degree of loss. The FACT System is proving to be a valuable tool in enhancing our efforts to combat fraud and corruption in government programs.

Also in 1981, the Department encouraged all U. S. Attorneys to form Law Enforcement Coordinating Councils with state and local law enforcement agencies in order to encourage mutual assistance and cooperation. White collar crime was promptly identified as one of their two highest priorities, second only to narcotics cases. This has lead to unprecedented cooperation in establishing local objectives, and in achieving an efficient division of responsibilities. Through one highly successful LECC program -- the cross-designation of federal, state, and local prosecutors to act temporarily as prosecutors outside their customary jurisdiction -- we have been able to staff many white collar crime cases that we would otherwise have not been able to process.

Over the past few years, we have begun to bring a variety of white collar crime issues to the attention of the Executive Working Group for Prosecutorial Relations. This is an

organization of representatives from the National District Attorneys Association, the National Association of Attorneys General, and the Department of Justice. This Group provides a regular forum for furthering the various federal, state, and local interests in important criminal law areas, and is proving to be an effective means of coordinating policy level approaches to white collar crime problems.

In 1985, the Antitrust Division -- in collaboration with the Defense Department, the Criminal Division's Defense Procurement Fraud Unit, and the Civil Division -- undertook a new program to root out collusive bidding schemes in connection with the military's procurement of billions of dollars worth of "off-the-shelf" goods and services. Among other initiatives, the effort involves educating defense procurement personnel to detect bid rigging more effectively, and to marshal evidence of collusion.

Also in 1985, the Land and Natural Resources Division prompted the creation of the National Environmental Enforcement Council, a group of federal, state, and local environmental law enforcement officials. This Council, which has already held two meetings, serves as a forum for the exchange of ideas, and as a mechanism for providing support for, and better coordination with, state and local environmental law enforcement activities.

## V. ENFORCEMENT RESULTS

As a result of these various management initiatives, over the past several years we have been able to prosecute more white collar offenses, and to do so more successfully than we have before. Our progress can be documented in part by statistics, but more clearly in terms of the significance of the convictions.

### A. Statistical Summary

The available data in the Department's Docket and Reporting System (which does not include data on tax, environmental, or

antitrust cases) indicates that the included white collar crime prosecutions rose as a percentage of total federal prosecutions from about 10 percent in the early 1970s, to about 20 percent in 1980 and thereafter. The average number of white collar crime cases brought annually for the past five years is approximately 5,500, up slightly from about 5300 during the previous five-year period.

In the area of environmental offenses, there has been a 200 percent increase in the number of criminal prosecutions since the creation of the Environmental Crimes Unit in late 1982. More than 180 indictments have been obtained, charging about 130 individuals and 50 corporations. Well over half of the individuals charged have been owners, directors, or high-ranking officers of the corporations involved. So far, more than 150 convictions have been obtained.

In the antitrust field, we have initiated more than 400 criminal prosecutions in the past five years -- more than double the number during the preceding five-year period -- and have won close to 90 percent of those cases. The great majority of these cases, including over three-quarters of those brought in 1985, have been against the primary target of the antitrust laws -- horizontal restraints of trade such as price fixing and market allocation. We have been particularly successful over the past several years in prosecuting bid-rigging conspiracies in the fields of public highway and airport construction, electrical contracting, and utility construction; over 60 percent of our 1985 criminal cases involved those industries. We have also brought many successful prosecutions affecting a wide variety of other goods and services.

The success of these endeavors is reflected in the number of white collar offenders incarcerated in federal prisons. Since 1980, that number has risen by 68 percent, and the number of

fraud and tax offenders who have been imprisoned has doubled. These figures should be viewed with the understanding, however, that there continue to be areas of white collar crime in which prison sentences are not imposed with sufficient frequency to serve legitimate punative and deterrent needs. This is particularly true with respect to defense procurement fraud cases and antitrust cases. In the former category, prison terms have been imposed on only about 33 percent of the defendants convicted; in the latter cases, our recommendations of incarceration have been followed by the courts only about 40 percent of the time.

B. Significant Recent Prosecutions

The numbers recited above do not begin to tell the full story. Certainly, they do not reveal the nature of the cases we have been bringing. That fact can best be grasped by referring to the Appendix to this statement. Compiled therein are brief summaries of some 300 representative white collar crime prosecutions handled by the Department last year. This compendium documents the nature, the extent, and the results of some of our most recent efforts.

Some of these cases merit special mention. Within a period of only 70 days last year, our national efforts produced the following results:

- General Electric Company was indicted and convicted in Philadelphia on charges of defrauding the Defense Department, and was simultaneously suspended from doing business with the United States Government. Two individual employees of General Electric were also indicted for perjury and obstruction of justice with respect to the grand jury investigation in the case, but were later acquitted at trial.

- Jake Butcher entered guilty pleas to several indictments and was sentenced to 20 years in prison for looting a series of banks in Tennessee and Kentucky. Two of his accomplices were also convicted and sentenced to prison.

- Paul Thayer, former Deputy Secretary of Defense, and Dallas stockbroker Billy Bob Harris were sentenced in Washington, D.C., to four years in prison for obstruction of justice in connection with their roles in a million dollar insider stock trading scheme.

- A 35-year prison term was imposed on Fred Soudan in Houston, Texas, for his role in devising the largest maritime fraud in history -- the sinking of the supertanker "Salem" off the west coast of Africa.

- Six defendants were convicted in Texas of Foreign Corrupt Practices Act violations in the $10 million Pemex/Crawford foreign bribery scheme.

- J. David Dominelli was convicted in San Diego on mail fraud charges in connection with the J. David Company investment scheme that defrauded 1,500 people out of $200 million.

- LeBlanc Brothers was convicted in Detroit for an investment scheme in which 800 investors lost $10.5 million.

- Convicted confidence man and boiler-room operator Jack Rose was indicted in Florida for perpetrating a precious metals scheme in which he defrauded 1,200 investors of $12 million.

- E. F. Hutton and Company was convicted on a plea of guilty to 2,000 counts of mail and wire fraud, was enjoined from abusive cash management practices, and was compelled to set aside a minimum of $8,000,000 for restitution in a complex "float" scheme.

I doubt whether there was ever a collection of more significant white collar crime developments in such a short period of time.

While the above cases fell under the general jurisdiction of the Criminal Division and the United States Attorneys, the other Divisions with criminal law enforcement responsibilities had several achievements last year as well. To mention only a few:

- In cases against Eli Lilly and Company and Smithkline Beckman Corporation, the Civil Division obtained convictions of two of the nation's largest drug companies, and their four most clearly responsible executives or employees, for criminal violations of a section of the Federal Food, Drug, and Cosmetics Act that makes it unlawful for a pharmaceutical company to fail to report to the Food and Drug Administration adverse reactions associated with its drug products. These were the first prosecutions under this 23-year-old law, and they have put all drug manufacturers on notice of the serious consequences of non-compliance.

- In December, the Land and Natural Resources Division obtained the indictment of Arthur J. Greer, the owner of companies handling hazardous wastes in Florida, on a variety of charges including mail fraud and six counts of knowingly placing employees in imminent danger of serious bodily injury. This is the first major case in which the

government has brought criminal changes under the Resource Conservation and Recovery Act of 1980.

- Following a three-year grand jury investigation, the Tax Division obtained a plea of guilty from Charles J. Walsh, a certified public accountant, to mail fraud and false pretense changes in connection with two fraudulent tax shelter schemes involving more than $17.5 million in equipment container leases and government securities. The defendant was sentenced to imprisonment for seven years.

We are pleased with the progress reflected in the above cases, and in those appearing in the Appendix. Our recent record is unprecedented. Still, we hear occasional criticisms concerning our efforts. Some of that criticism may be warranted, for we do have room for further improvement, but some is unwarranted. Concerning the latter, two observations are in order.

First, any suggestion that the Department has failed to pursue white collar criminals vigorously and effectively is utterly without basis. Nevertheless, misassumptions exist. We hear claims, for example, that the Department does not prosecute major companies, or that in cases of corporate crime it rarely prosecutes the responsible officials, or that it has failed to seek prison sentences for convicted offenders, or -- more generally -- that the Department's recent enforcement efforts have fallen significantly short of those in previous years. Anyone who takes the time to examine the facts knows better.

Second, any suggestion that our enforcement efforts have been adversely influenced by the supposed "pro-business" orientation of this Administration is nonsense. American business certainly does not benefit from lax enforcement. Any such suggestion is also insulting to the career professionals in the Department who make the overwhelming majority of decisions

concerning the investigation and prosecution of criminal cases, including white collar crime cases. These dedicated public servants are the ones who decide -- solely on the basis of legitimate law enforcement considerations -- whether to seek court ordered "use immunity" for a witness, whether to prosecute a particular defendant, and whether and on what terms to enter into a plea agreement. Few of these issues reach the level of Presidential appointees. When they do it is either because there is a close question on which the career people disagree, or because the unusual sensitivity of the case warrants consultation with senior officials. On the rare occasions when political appointees do become involved, they decide the issues on the merits, and almost invariably affirm the positions taken by their subordinates.

## VI. MEASURES NECESSARY TO CONTINUED SUCCESS

The continuation of a successful law enforcement effort requires a number of steps to maintain and accelerate the momentum we have built up over the past several years. There is much we can do alone, but we cannot be fully successful without the support of the Congress and the judiciary.

### A. Priorities

Initially, it is essential to have a common understanding of the appropriate direction and intensity of future federal law enforcement efforts against white collar crime. These hearings provide an ideal opportunity for reaching such an understanding -- and indeed for reaching a consensus. What is required is clear thinking -- unencumbered by myths and misassumptions -- on the part of all concerned, a fair assessment of the record to date, and a crediting of mutual good intentions.

We think our efforts have served the interests of the American people. We also think that anyone who disagrees with

the investigative or prosecutorial judgments made in the thousands of white collar crime cases the Department has handled may appropriately be understood to bear the burden of explaining what should have been done differently under the circumstances and of showing how that would have produced better results. Similarly, any criticism of the priorities we have chosen, or our use of resources, might profitably be accompanied by the identification of more appropriate priorities or of a better allocation of resources. On the basis of the knowledge and experience we have gained from close involvement with this area over the years, we very much doubt that hindsight would suggest a materially different course. In any event, we would welcome constructive suggestions with regard to our strategy and the manner of its execution.

In this regard, we recognize, of course, that law enforcement efforts must keep pace with developments in white collar criminal activity. White collar criminals are inventive, and their schemes are constantly changing. We must be prepared, therefore, to shift priorities or resources as the occasion requires. The administrative mechanisms we have set in place should facilitate the necessary flexibility.

B. Resources

White collar crime law enforcement is, as we have noted, an inherently resource-intensive undertaking. In fact, this area of

C. More Effective Tools

Attention to priorities and resources must be matched by efforts to fashion up-to-date tools for responding effectively to the increasing sophistication and ingenuity of white collar offenders. Congress has already done much in recent years in this regard. We are particularly pleased by, and have been materially assisted by, the enactment of the Comprehensive Crime Control Act of 1984. That legislation included a number of

measures we had long sought to assist in detecting, prosecuting, and punishing white collar crime. Particularly useful are the Act's provisions relating to currency and foreign transaction reporting, program fraud and bribery, bank fraud, bank bribery, trademark counterfeiting, credit card fraud, computer offenses, and sentencing -- including substantially enhanced five levels and creation of a future guidelines sentencing system.

But the role of Congress did not end with passage of the Comprehensive Crime Control Act. There remains an urgent need to enact additional measures in this area, as well as to guard against unwarranted weakening of those already adopted, such as the bank bribery statute.

We have proposed to the Congress a number of legislative initiatives that, if taken, would significantly enhance our ability to stem white collar crime. These include a comprehensive money laundering bill that would impose stiff civil and criminal penalties on individuals and institutions that launder the cash proceeds of criminal activities. That bill was submitted to the Congress on June 13, 1985, and was introduced on our behalf as S. 1335. It would substantially strengthen our ability to investigate and prosecute the widespread money laundering associated with drug trafficking, organized crime, white collar crime, and tax evasion. Since its introduction, court decisions have seriously undermined our limited existing ability to strike effectively at the "washing" of illegal monies. The need for action on S. 1335, therefore, is even greater than it was when the bill was introduced eight months ago. Yet, while there have been hearings in the Senate and House on money laundering legislation, we are sorely disappointed that no action has yet been taken in either chamber to report a money laundering bill from committee.

In addition, the Department submitted to the Congress an important eight-bill Anti-Fraud Enforcement Initiative last September. While three of these eight bills have been reported

by committee in the Senate, none of the bills has been taken up by the full Senate. In the House, only one hearing has been held, and it encompassed only two of the eight bills.

One of these bills submitted in the Initiative is particularly important to the ability of the government to combat fraud, waste, and corruption. I am referring to the proposal to amend Rule 6(e) of the Federal Rules of Criminal Procedure to permit more ready sharing both to other government agencies and to civil attorneys within the Department of Justice, of information developed by federal grand juries. Frequently, a federal grand jury investigation of white collar criminal activities, whether or not it results in an indictment, will reveal substantial evidence of significant illegal activities that could, if known to an affected agency, be pursued through civil or administrative sanctions. Yet as a consequence of recent Supreme Court decisions interpreting Rule 6(e), disclosure of such information is very difficult or impossible requiring it may not -- even to attorneys in the Civil Division of the Department -- a court order based upon a showing of "particularized need". The legislation we have proposed would maintain appropriate safeguards against needless or cavalier revelation of grand jury information, while still permitting a reasonable degree of flexibility within the government in the pursuit of fraud and misconduct.

We urgently need these new statutory tools if we are to be more effective against the most serious forms of white collar crime. We need the help of the members of this Committee in obtaining them. We strongly encourage speedy and favorable floor consideration of both the money laundering and the anti-fraud measures.

For our part, we do not intend to rest on the administrative achievements of the past few years. We will continue to seek new methods of making our white collar crime law enforcement efforts more efficient and effective. To that end, we are determined to implement the use of an Economic Crime Index designed to facili-

tate the exchange of information on white collar criminals among concerned law enforcement agencies. This Index, the development of which was proposed by the Economic Crime Council and the necessity for which we have studied carefully, will provide a mechanism whereby various federal, state, and local law enforcement agencies can ascertain quickly whether they are conducting investigations of the same suspected offenders or schemes. If it appears that they have a common interest, the agencies can then proceed in the normal manner, through existing legal and administrative procedures, to exchange information concerning their two investigations. It is our view that such a system is practical, lawful, and reasonable. It will materially enhance the effectiveness of federal and state efforts against white collar crime, without in any way infringing upon other legitimate private or governmental interests.

D. Sentencing

One of the critical weaknesses in the enforcement of the laws concerning white collar crime continues to be the failure to achieve, on a regular basis, appropriate sentences for white collar offenders. This problem exists primarily because of erroneous perceptions that white collar crime is a less serious matter -- deserving of less serious sanctions -- than other, more visible or more immediately threatening forms of criminal behavior.

It is not less serious. Persons convicted of significant white collar offenses -- which are the ones we prosecute -- should ordinarily be incarcerated, at least for some period of time, in order to deter others and in order to assure legitimate punishment. Moreover, non-prison sentences, when appropriate, should have some discernible "bite," and should not consist of lenient "community service" requirements that tend to erode public confidence in the concept of justice. Full use should also be made of enhanced fine levels and other recent sentencing reforms, particularly in cases of convicted corporations.

In creating the United States Sentencing Commission, Congress recognized the need for reform of these and other aspects of federal sentencing. We are hopeful that the Commission's work will provide the specific sentencing guidance that is needed, particularly in the white collar crime area. To help make that hope a reality, we have assigned various components of the Department the specific task of assisting the Commission in its efforts to develop white collar crime sentencing policies and guidelines.

While the Commission's work is proceeding, however, we think that every effort should be made to convince sentencing judges that inappropriately lenient sentences constitute a serious hinderance to white collar crime law enforcement efforts. We suggest that the best place to begin would be for Congress to rescind the Sense of the Senate Resolution it adopted as Section 239 of the Comprehensive Crime Control Act of 1984. That Resolution, which purports to provide guidance to sentencing judges concerning the appropriateness of imposing prison terms during the interim period before the Sentencing Commission's guidelines become law, is confusing at best, and is far more likely to benefit white collar criminals than to serve the needs of society.

Finally, as a general matter, all of us must realize that there are limits to what the criminal process can do. We must recognize the potential contribution to effective enforcement of other mechanisms for securing compliance with the law, particularly civil and regulatory sanctions. We must also encourage the business community to adopt informal strictures against

engaging in behavior that borders on illegality, since what is needed, ultimately, is a heightened sense of moral responsibility and sensitivity in the conduct of economic affairs.

## VII. CONCLUSION

As I mentioned at the outset of this statement, we welcome the opportunity these hearings provide to inform members of the Committee and others in Congress of our philosophical and practical approaches to the challenge of white collar crime. We take pride in our accomplishments. Yet we realize that there is more to be accomplished. We invite the constructive participation of the Congress, in the exercise of its legislative and oversight responsibilities, in forging an even more effective program to protect the Nation, and its citizens, from the consequences of serious white collar crime.

Senator MCCONNELL [presiding]. Thank you, Mr. Jensen.

Senator Biden will be back. He had to go up to the Foreign Relations Committee briefly.

I have a few questions Chairman Thurmond has asked me to ask and we are going to deal with the questions in 10-minute rotations and when I finish, we will go to Senator Metzenbaum and then Senator East.

Fraud and defense procurement has been of particular attention in the Congress and the media recently. You have indicated in your written testimony that the Antitrust Division of the Department, in collaboration with the Defense Department and the Defense Procurement Fraud Unit have worked together to educate defense procurement personnel to detect bid rigging and collusion. How successful do you believe this effort has been and what further measures in this regard would you anticipate and desire in the future?

Mr. JENSEN. Mr. Chairman, as I indicated, in 1982 we formed the Defense Procurement Fraud Unit. It was essentially put together in the Criminal Division, working with the Department of Defense, lawyers and investigators, and with the FBI. We have gone forward and we will describe all of that.

With reference specifically to the Antitrust Division, their participation in this specific area of enforcement is new. It is just getting put together and it will be moving forward. We would like to describe that.

The Antitrust Division has done a lot of work in collusive bid rigging, as we say, and in areas that will be relevant for procurement fraud. We are adapting it to the specific area of procurement fraud. That is a new initiative and it is one that does not have a track record that I can point to. I can give you a description and will be happy to do that in terms of how we are putting it together, where we intend to go and what we think will be available to us. It does not have a track record through that fraud unit that we can point to because we have just started it.

Senator MCCONNELL. You mention that a corporation that engages in criminal activity should be forced to adopt internal controls and to substantially alter the ways in which it conducts its affairs. I presume you mean beyond the criminal act itself, since that is assumed in any sentencing. I would like for you to be a bit more specific on this, if you would.

Mr. JENSEN. You are correct in that we are talking about internal controls that go beyond the direct criminal conduct. What we have found is that oftentimes this is a voluntary act on the part of the corporation once they find this kind of problem before them. We have seen this in many instances, where, say, either lawyers or accountants have been brought in to assess a situation and to give direction to the corporation and say how they may best put in place controls that will deal with this issue from a preventive standpoint as they go forward.

In many instances, it has been done voluntarily. In many instances it has been done as a result of some disposition of the criminal case, but we worked this out as a part of what we expected for the future conduct of corporate behavior and to address the problem of potential crimes that might be there.

The internal controls are a very effective way of approaching this. We found that, as I say, in most instances there was voluntary movement in that area. In some instances we have accomplished it as a part of a dispositional package, to have that as a part of an agreed future as far as the corporation is concerned.

We think it is very important and we think we can achieve it, but we think it is a basic kind of reaction. It is a part of the thinking as corporations realize what has been going on, what their responsibility is in this area.

Senator MCCONNELL. You have indicated that incarceration of white-collar offenders has risen steadily since 1980. What impact do you believe incarceration of white-collar offenders has had on deterring this type of crime? How has alternative sentencing undermined the deterrent effect of prosecution of white-collar crime? What proposals do you have in this area?

Mr. JENSEN. As I said, I think this is one area where imprisonment and the sanction that is implicit in that is one that has a deterrent effect not only on the individual who suffers that sanction, but on others who watch. One of the issues in criminal justice, of course, is the general deterrence factor as a result of people realizing that this conduct is capable of being detected, investigated, prosecuted and that upon conviction the persons who are responsible are going to go to prison.

We think that there is a general deterrence factor that is there. One of the things that we have seen with corporate behavior as we have imposed criminal sanctions upon corporate entities is a movement to do specific things with reference to, for example, ethical training. Corporations have moved into areas of actually putting on ethical courses for their employees and officers. We have seen responses that show a level of sensitivity to this in terms of corporate behavior in the future.

As far as the criminal sanction it imposes on individuals, as I say, we think that it has both specific and general deterrence as a very real value that can be accomplished by imposing such sentences.

Senator MCCONNELL. In your testimony you referred to the role of the Economic Crime Council in identifying for prosecution economic crimes that are of national significance. What criteria do you use in identifying for prosecution economic crimes, what mechanism or procedure does the Economic Crime Council utilize for advising departmental officials concerning the necessary allocation of investigative and prosecutorial resources to ensure prosecution of crimes the council has identified to be of national significance?

Mr. JENSEN. The identification of these issues—and I mention priority areas—to a great extent is dependent upon their presence as a phenomenon in the communities of this country. We have found the areas of priority result from high levels of criminal conduct in those areas that require our attention.

We like to be out in front if we can, of course, but it becomes somewhat difficult in some areas. What we have done is look at, for example, the area of bank fraud. We found that, as I mentioned, a high percentage of bank failures were the result of the criminal conduct of bank officers and that as we looked at that, we needed to develop programs that would enable us to reach into that, and prosecute it at the Federal level.

We set up an interagency group to come up with better referral mechanisms, an interagency group to now monitor and to move in on the more significant prosecutions. The Economic Crime Council did that by, one, looking at the problem that came to their attention because of criminal conduct itself, by having an operations group that developed procedural plans to now move forward and have the Attorney General bring in the heads of the banking regulatory agencies to sit down and to put together a group and then to draft the future in terms of an interagency kind of approach.

So the way we did that was by, one, identifying the problem in terms of what was actually happening in the arena itself and then using a staff support to the Economic Crime Council and then reaching out to the other regulatory agencies. That is an example of the work of the council. Basically, the council sits and in a collegial way develops a sense of what is going on in terms of the enforcement efforts by U.S. attorneys around the country.

The Council itself, by our definition, includes in its membership of each of the U.S. attorneys who are in the so-called regional and inspector general cities. There are 10 regional cities, 10 cities in regions in this country where inspectors general have their headquarters. We make sure that each U.S. attorney in those areas is a part of the Economic Crime Council so we will have the best liaison we can with the inspector general community.

That is essentially how we develop it, simply by observation of the problems there and then using the mechanism to develop implementing kinds of responses.

Senator MCCONNELL. In your testimony, you indicated that there are instances in which a noncriminal approach to white-collar crime might be preferable to criminal prosecution. On what beliefs do you base this opinion and what contemporary examples can you cite where such noncriminal treatment would be desirable?

Mr. JENSEN. There are areas where—the criminal process, as you know, is one that goes into events that have already taken place and attempts to impose sanctions upon past conduct. In that sense, it affects future conduct only by indirection, in that it achieves this general deterrence I spoke of before and it has an impact upon an individual offender.

Outside of the criminal justice process, we have now available some civil process, for example, that allows us to enjoin practices so that we can move in and prevent the conduct from taking place. The general area of prevention of conduct is one that adapts itself to the use of the civil process, rather than criminal, and so in some areas we are able to do that.

E.F. Hutton was the first use of the massive injunction that was available to us or made available to us in the Crime Control Act of 1984. That is a good example of using an injunctive process, but we used it there as a corollary to a criminal prosecution. That is the

kind of thing that we can use in the civil arena to accomplish prevention that would not be as easily or effectively accomplished by criminal prosecution.

Senator MCCONNELL. One final question. In the area of environmental law, you identified a difference between criminal corporate conduct within and outside the regulatory scheme. Could you expand on this distinction? How does the Department of Justice respond to these types of criminal conduct differently?

Mr. JENSEN. If I may, let us give a written response to that. I did not go into the environmental unit more specifically, but if you want to do that specifically I would submit a written answer to that.

Senator MCCONNELL. That is fine.

Senator Metzenbaum.

Senator METZENBAUM. I was just glancing through this book and I could not read all of it, but I noticed the Kirkpatrick case where they bribed a Nigerian national in order to get a contract in violation of the Foreign Corrupt Practices Act, and paid out $1.7 million in bribes. Mr. Carpenter was chairman of the company and was sentenced to 3 years of probation, 200 hours of community service, and ordered to pay a fine of $10,000. Do you have any comment on that?

Mr. JENSEN. I think we could look at that case more specifically in its context and perhaps there is more context we could give. But in terms of just a general reaction, I think that follows from what I have said that I think is a matter of concern. Is this the appropriate level of sanctions for conduct in the white-collar crime area. I think there are real problems in that area and that we need to reach an understanding and an attitude within the system that gives proper recognition of the severity of this kind of conduct, and I would think that sentence is light.

As I said, I do not know the exact context, but one should always do that——

Senator METZENBAUM. Was there plea bargaining?

Mr. JENSEN. I do not know that case, Senator. It is the sort of thing that we ought to look at. I think that is something that is a very important consideration for this committee and also for the Sentencing Commission, who are trying to come up with a way that we would be far more likely to look at white-collar crime offenses and say to ourselves, "let us make the punishment fit the crime." We have not done that as much as we ought to.

Senator METZENBAUM. Well, I am concerned about some matters in which you were involved. In the Justice Department fact sheet made available to the committee, you make the point that the fine imposed on the Lilly Corp., which is $25,000, was the maximum fine under the law in effect. Well, that is true if you prosecuted them for a misdemeanor rather than a felony, but as a matter of fact you permitted a plea agreement to be made with the misdemeanor prosecution, and you go on to say in your comments that recent amendments to the Criminal Code might have put that fine at $2.5 million today.

That is true, but the real issue is why did you not prosecute them for the felony? You recognized that they paid fines of $25,000

for the corporation and $15,000 for an individual, $40,000, and made around $500 million a year, so that is obviously nothing.

Now, in that case you personally overruled the prosecutorial recommendations of the Civil Division in the Lilly matter, is that not correct?

Mr. JENSEN. They were recommendations, that is right, and we have had a final disposition.

Senator METZENBAUM. The staff wanted to prosecute them for felonies.

Mr. JENSEN. There may have been some, there may have been different—I think that there were lawyers who had that opinion, and there were lawyers who had different opinions.

Senator METZENBAUM. Let me just read this: "The Deputy Attorney General of the United States acknowledged today that he had overruled staff lawyers who wanted to prosecute three officials of Eli Lilly & Co., for failing to disclose deaths and ailments"—excuse me, this is a different case, this is the *Oraflex* case. I am sorry.

Mr. JENSEN. Senator, I know that you are specifically interested in going into those cases in depth and you indicated that would be a part of this process. We would be very happy to do that, and what I would suggest is that we would prepare and get ready for you whatever information you would like to seek in those cases and present it as a part of these hearings. I think, knowing of yor interest, that we would be happy to go into it in much more specific fashion in those cases. We will do that in the future.

Senator METZENBAUM. You prefer to get into those three cases at a future date?

Mr. JENSEN. Surely.

Senator METZENBAUM. I have no objection to doing it that way, Mr. Chairman. I think that we ought to be calling some witnesses. I think we ought to hear from the Attorney General's office in connection with those cases, and I have no particular reason to push the question today, some of which Mr. Jensen may or may not be prepared for and I certainly think he ought to have an opportunity to get into that. Most of my questions have to do with those cases and I am not going to push them.

Let us talk for a moment about the *E.F. Hutton* case. I think you mentioned something about what, was it $8 million in restitution or something of the kind? I do not know of any case that more permeated the common concern of the average American who had any interest at all in this subject. A lot of Americans have no interest whatsoever, but since it was E.F. Hutton & Co., they could understand that kind of violation—they could particularly understand that they cannot kite checks at their bank and get away with it probably without winding up in the slammer. They see these big officials and when they see the Attorney General of the United States go on television and come to my own community and make a great big hoopla that we are really getting tough on corporate crime now when something like $11 billion of checks that were kited, we know that some of the officials were not telling the truth. We subsequently read about how managers of E.F. Hutton who came before congressional committees and indicated that it was indeed company policy, and yet they got away with it. We are all realists enough to understand that you are part of E.F. Hutton &

Co., and paying a fine or something is really quite unimportant to you. You can make that much the next day, and the $8 million is probably the kind of money in this kind of market they can make in a day or maybe hours.

How do you explain the fact to the American people, that the department decided not to prosecute anybody in such a way that somebody might go to jail?

Mr. JENSEN. I would anticipate, one, that we would spend some more time in the specifics of the case and I think that having expressed that interest, we would like to show you. We have already, as you may know, Senator, in the other House had——

Senator METZENBAUM. What is that?

Mr. JENSEN [continuing]. Before other committees we have had extensive hearings on that cost and there has been a great deal of public disclosure of its history that would basically refute what you have assessed as public perception of what really took place. There has been a great deal of explanation about that on the public record now. We would be happy to do that here also within this committee.

One of the things I would say at the outset is that there is, of course, an initial threshold question as to whether or not we are going to charge any individuals based upon the facts and the law that would support cases against them. We have to be in a position to prove cases beyond a reasonable doubt, as I pointed out before. We have already made the point, in the other hearings, that we did not have such cases against top officials in E.F. Hutton.

There were cases that were made as a result of some insiders telling us what took place. There were levels where people cooperated with us. There were a couple of cases that could have been made against midlevel managers. We chose not to seek that in light of the determination that the disposition we got was far more effective and had far more of an impact upon both the money market or the money management area. We were able to achieve really remarkable results by way of the injunction and the signal that went out as a result of the conviction in E.F. Hutton. The fines were unprecedented. The restitution that was made was in order and we would not have been able to achieve this in any way, shape, or form by prosecuting individuals.

We reached levels of restitution and impact upon money management that could not have been achieved with prosecution against individuals. The judgment in that area was based upon not only the facts and the law, but what would be the most appropriate kind of disposition available. We think that that judgment was a correct one, made by the investigators and lawyers responsible for it. We stand by it. We think that, having now explored in great depth what took place in the *E.F. Hutton* case, what actually took place is a remarkably successful prosecution and one, as people understand what took place, and it has been now a part of the public record, it is one that we can take pride in.

Senator METZENBAUM. I recollect very clearly on the front page of the business section of the Washington Post a picture of a tall man indicating he was the senior vice president or executive vice president or something of the kind of E.F. Hutton, in which he indicated the senior officers knew what was going on and approved of

it. Are you saying to me that either my recollection is wrong or that that man or the reporter was wrong who reported it that way or that it did not occur at all?

Mr. JENSEN. I do not know what the recollection is, Senator. I would not be able to answer as to your recollection, obviously.

Senator METZENBAUM. Well, my recollection——

Mr. JENSEN. I know your recollection is good. What you are saying, however, has to be put into a context of case as to whether or not it provides any evidence of criminality, what it is. I do not know that I can answer that in any fashion right now.

What I am saying is that the judgments that were made were based upon the evidence and law available to us and we stand by those judgments.

Senator METZENBAUM. Well, my staff just handed me a Wall Street Journal, July 2, 1985, clip:

> Hutton memos show approval of overdrafts. Ex-President Ball cleared firm's system to handle some checking accounts. When he was President of E.F. Hutton & Co., George Ball personally authorized systematic overdrafting of company bank accounts, according to internal Hutton documents and interviews with former employees.

I never was a criminal prosecutor, but that sounds like pretty good evidence on which to move forward. If the Wall Street Journal could get it, I somehow have the feeling that with all the resources of the U.S. Attorneys' Office, they could obtain that same kind of information.

I guess what I am saying is that the general perception of the American people was that these people got away with something. I happened to notice in one of the cases you submitted to us, *United States* v. *Robert McCormick*, that Mr. McCormick was involved in a check-kiting scheme causing two banks to lose $117,365.75, and his daughter was involved also. Mr. McCormick was sentenced to 18 months in prison, plus 3 years probation and ordered to make restitution of $31,000; his son was sentenced to 6 months in prison, 3 years probation and ordered to make restitution of $80,000.

I am just trying to understand how it is that these people of whom I have never heard before, from your own report to us, how it is that they wound up going to prison but E.F. Hutton people were not even charged. You did not even make the effort to charge E.F. Hutton. They really got away with something in the eyes of the American people and nobody has been able to explain why you did this. You say it was great, they will not do it again now and all of that, but Mr. McCormick as far as I know only did it once, at least in your recitation he only did it once and he wound up with 18 months in the slammer.

Mr. JENSEN. As I said, we would be very happy, and I think it would be useful, to have this committee that has now started in on a comprehensive look at white-collar crime prosecution and results, to now look at E.F. Hutton, because, as I say, there are a good many misapprehensions and perceptions that are out there that need to be stripped away. There are areas of whether or not there was a proper judgment made as to individuals and corporations. We think that the judgment that was made in E.F. Hutton is sound, and it is the kind of judgment we will make in white-collar crime cases.

We think that when you get to the assessment of specific sentences, that is a broader topic and, as I said, we will be very happy to discuss that with the committee. So I think what we need to do is, one, to have a level of discussion of the *E.F. Hutton* case that brings a good deal more to it than, with all due respect, Wall Street Journal articles or headlines. We need to now give a good deal more context to it. We will be happy to do that.

Senator METZENBAUM. The chairman's staff indicates that it is intended to get into the *E.F. Hutton* case.

Mr. JENSEN. Fine. We will be glad to.

Senator METZENBAUM. And I will withhold any further questions either in connection with some of the other company prosecutions or lack of prosecutions as well as the *Hutton* case.

Thank you.

Senator EAST [presiding]. According to the staff, Senator Biden may want to return in a bit to ask some questions.

I would propose that we might take a recess for 10 minutes and give you a chance to do whatever you would like to do in that 10-minute period and then we will gather here at the river and assess where we are and if there are others who have questions they wish to pursue we will do that, otherwise we may be able to adjourn at an early time.

Mr. JENSEN. Thank you very much, Senator.

[Short recess.]

Senator HATCH [presiding]. The committee will come to order.

Mr. Jensen, let me ask a couple of questions while we are waiting for Senator Biden to come. Given that there are limited resources available to fight crime, do you believe that the current allocation of resources represents the most effective use of our Federal dollars and manpower to combat white collar and other crime?

Mr. JENSEN. I think that it does, Senator. However, I would like to add that one can never be satisfied that you have the best management mix and focus of your resources without constant attention. What is really the purpose of an institutional kind of response such as the Economic Crime Council. We get U.S. attorneys who are on the firing line, who are dealing with this day by day, who know what the problems are in terms of use of the resources, and what is actually happening to investigations.

I think that our mix of resources is a good one now but I think it is also important to state that you cannot let that rest. This is a dynamic situation and not a static one.

Senator HATCH. Are the fines you are seeking in line with the income or revenues of these violators? How do you calculate the amounts that you seek in each case?

Mr. JENSEN. In a lot of instances, it is simply the maximum amount that is available by law. We have already made an allusion to that. In terms of fixing sentences within ranges that are permissible by statutes and convictions, it would really be the—it is not the level of income that really directs this. What directs it is the severity of the offense. The punishment should fit the crime, and even in economic crime you have different levels of offenses and you have economic impact or impact upon individuals such that you have different levels of severity. We adopt the notion of seeking a fine that is commensurate with the level of the severity of

the crime, rather than something like a measure of the income of the offender.

Senator HATCH. Thank you, Mr. Jensen.

Let me turn the time over to Senator Biden.

Senator BIDEN. Thank you very much. I sincerely apologize. Your colleague, Mr. Shultz, is upstairs in the Foreign Relations Committee on the not at all very controversial issue of $100 million in aid for the Contras.

Mr. JENSEN. It would be an interesting hearing, I understand that.

Senator BIDEN. So I am sorry. Let me say at the outset that I thank you for your statement. I detect that you get a sense of the spirit in which this thing is undertaken at this point, at least by the chairman and I specifically, and I appreciate the offer of cooperation with the committee.

My questions along those lines are going to be probably particularly boring to everyone, but hopefully though we can make a record a little bit here so we have a basis upon which to begin.

You spoke to this earlier but I would like to get it clarified. In the 1980 Attorney General's Annual Report there was a definition of white-collar crime. Have you attempted to or do you have any plans to change that working definition of white-collar crime?

Mr. JENSEN. I do not think that we are considering changing that definition. I think that we are approaching it more from putting in place within the institution some systematic ways of responding to the topic of white-collar crime, and that is what that council is for. It allows a broader kind of responsive mechanism. You can get yourself into perhaps too narrow a labeling process and we really do not want to put on too narrow a label. We want to achieve some level of flexibility and it is difficult. It is an elusive concept.

Senator BIDEN. In your view, does your current working definition of white-collar crime adequately distinguish between the various kinds of fraud, for example, welfare fraud, which you mentioned, and defense fraud?

Mr. JENSEN. Well, I think that it permits us to make the kind of focus. One of the points that was made here is a point we obviously share and that is when you look at something like defense procurement, that is a peculiar kind of Federal responsibility. It is not one of those that is complementary or concurrent with State and local enforcement, and so you ought to give it greater attention and more focus. That is why we put a unit together, to have that kind of staffing in terms of lawyers and investigators, and that I think is the definition, rather than any other sort of label. We do not really rank them and say that a violation of $x$ offense or a violation of $x$ statute is more important than another. You really will not know that until you work up the cases. I think you do it more by commitment of resources and lawyers than you do by definitions.

Senator BIDEN. Well, at the end of this whole process I would like to raise the question, not at the end of this day but at the end of the series of hearings, the question of a clearer and I would suggest maybe a more appropriate definition of white-collar crime that may be helpful, but let me move on.

Based on your statement that while the Department does not have an estimate of the overall impact of white-collar crime on the

Nation in any specific sense—and I can understand that—do you have any estimates of the component parts of white collar, for example, price fixing, insurance fraud, securities fraud, bank fraud, defense fraud, tax fraud, money laundering, and health care fraud?

Have you attempted within the Department at this point to try not necessarily to prioritize in terms of what you go after first, but get a handle on, like you did with drugs, for example? It was not until 1979 when we really started to and you brought to fruition, we did not have clear distinctions between how much of the drug problem was marijuana, how much of the drug problem was cocaine, how much of the drug problem was heroin, how much of it was synthetic drugs.

You have done that now and have you done anything like that in the white-collar crime area along the areas I have mentioned?

Mr. JENSEN. We have not done it in terms of setting up more specific measurement devices that you suggest. I think that it is one of the areas we would like to address. Actually, the Department as a whole needs to have a management information system that lets you do a better job of management. We are developing this from the standpoint of the total Department, and it will apply to this area.

It will allow us, for example, to use the figures that I mentioned in the docket and reporting system the U.S. attorneys have now. It is not a very sophisticated system and you have to reach out to have it tell you things about white-collar crime.

We are putting on top of that a management information system that should allow the Attorney General to be better about answering questions in terms of specific data. However, once again, we do the same thing as assessments of relative significance by priorities. We use priorities in defense procurement, in health care providers, in boiler rooms. That is a functional kind of decision, that those are high level, significant areas of sufficient volume that we ought to pay attention to.

Senator BIDEN. I understand that and, again, I do not expect this to be the end of our discussion on this, but you made a very persuasive statement about the pernicious effect of white-collar crime on society as a whole. For example, the insurance industry, as you know as well as I, puts the fraud level in their industry at about $11 billion a year and they suggest that that requires everybody in the United States who carries insurance to be paying about $13.75 a year more than they otherwise would have. And if you take the estimates of the Department of Defense fraud, you are roughly talking about—if you take all fraud in Government—the various studies and some of the people are going to come up here and testify to this effect—you know, at the low end it is about $9.95 billion by these estimates per year and at the high end it is $99 billion per year.

The reason I bother to mention this is you pointed out how it can have such a corrosive effect and let us assume for the sake of discussion, so I understand your prioritization, let us assume we knew without a doubt that there is $100 billion worth of white-collar crime and that $90 billion of that was coming from bank fraud, for example. I would suspect what you would do, notwithstanding the fact there may be serious cases in health fraud or the defense

fraud area that are more serious than individual cases in the bank fraud area. Notwithstanding that, I suspect you would train more of your people in the unique aspects of bank fraud, rather than something else.

Mr. JENSEN. I think that is absolutely true, as you make the decisions. We have to say to ourselves that there is a level of finite resource we are dealing with now, and we have got to focus it in where we get more bang for the buck.

One of the measurements is going to have to be the dollar loss, but I think we probably need to have more sophisticated ways of measuring. We search for those all the way down the line, is that it has got to be these dollar losses that have the kind of collateral of multiplier effects that you speak to, and to the extent we can do that, that is an economic analysis.

Senator BIDEN. Yes.

Mr. JENSEN. We ought to do more of that than we do.

Senator BIDEN. The IRS, as you know, has been working in certain limited areas to estimate illegal income, including from white-collar crime, and I suspect you have been and will be in contact with them and work with them, at some point, and we can talk more about that later.

You talked about a set of priorities. For example, you have set through the Economic Crime Council, established in May 1983, as I understand it, the following priorities: Defense procurement fraud, fraud against banks, investment fraud, money laundering, securities fraud, and health care fraud. But to me the key question really is how are you translating these into efficient and effective law enforcement strategies. We can set priorities, but they are meaningless, unless there are strategies to follow up on the priorities.

What I would like to talk about for a moment or, if you would rather submit it for the record if you have a time constraint, is does the department have a strategic plan to deal with these priority areas.

Mr. JENSEN. There are followups up to the priorities. I think you are exactly right, that you could simply articulate priorities and it is an exercise in rhetoric. Defense procurement has the whole unit now that expresses the implementation of its priority. The Economic Crime Council drives the kind of education that has to go out to investigators and lawyers to be able to deliver these kinds of cases, so that you follow up in that fashion.

The health care provider, for example, is the sort of thing that we could give you. We are developing some areas right now where we are using model prosecutions and bringing the prosecutors to do these cases together to teach them how to do it so that they can go back home and make the kinds of cases that are in that priority area.

Senator BIDEN. I am not sure we will end up doing what I am about to suggest, but I do not want to be coy about this. I am, after 12 years on this committee and going on 14 years in the Senate, on a sort of gradual basis, Mr. Chairman, reaching the conclusion that the Justice Department, when it was set up, having nothing to do with this administration, and it continues to act in some respects like a 19th century law firm, and I do not say that—I realize grabbing hold of this bureaucracy by the horns is a hard thing, and as

we have moved along the more I have become acquainted with it. But I am beginning to raise, which I will get back to another time with you, but I just want to be up front with you, I am beginning to in my own mind wonder whether or not, just as we are looking at restructuring of the Defense Department and we have restructured parts of the HHS, which you know better of than I, Mr. Chairman, and so on. I have reached no conclusion, but I ask the questions I am asking in the context of what seems to me to be sort of an emergence of how do we have functionally and strategically to change to deal with the emerging problems, and let me be very specific.

When I asked about strategies to deal with defense procurement, for example, you point out that there is a Defense Procurement Unit now 'and I compliment you on that. I am not being solicitous when I say that. I mean it sincerely.

But just as under the Carter administration and the Ford administration, we set up various drug control units within the Justice Department. It was not until you guys came along that you really started to get that ball rolling and not only had priorities within the drug area, in addition to that you had strategies and some of the strategies we are seeing playing out right now in New York courtrooms as to what you decided to do, where you were going to strategically allocate your resources and what your targets, not that you went out with specific name targets but in a generic sense where you were going to go.

So at some point down the road I would like to, out of all of this and as we go along, maybe get a better sense of how you are developing that strategy. I do not expect you to have it all, any more than—and, by the way, I should note for the record that your—criticism may be too strong a word—but your pointing out the resolution that the Senate passed with regard to nonviolent offenders is an example where I think we here have to say what I hope you will be willing to do if it turns out.

You are right and, for the record, I should note that, remember, that was originally going to be a statute. Part of the reason why it ended up in the way of a resolution is because you all convinced me that that would be a bad idea, but the problem was do we swallow a resolution or do we run the risk of the statute. I may have made a tactically inaccurate judgment and swallowed the resolution, but you are right, I think the Congress has to begin to acknowledge that, although there are some safeguards, we have got Nagle and others on that commission who know a lot about, as you do, about white-collar crime and we may not have a problem as much as we thought.

It is in that kind of spirit I hope we can deal with some of this, and so as we go I want to—again, I do not want to kid you, I am looking at whether or not my instinct is right or wrong about the need to have better strategies based on dealing with what is obviously a burgeoning white-collar crime problem. That is why I asked the question.

I have a few more, if I may. You tell me when to stop.

Senator HATCH. Go ahead. He has been here a long time.

Senator BIDEN. I know he has and I appreciate it and I will submit a bunch of these for the record, because we have plenty of time to go over this.

Mr. JENSEN. I would be happy to do this but we could——

Senator BIDEN. I will not take more than 5 minutes if I may, but it will not be much more. I will submit the vast majority of these for the record.

Let us talk for a moment about another important part of the inquiry you made reference to. As I have said and you have demonstrated in the past to me, and I hope this is a cooperative effort as we go through the next 2, 4, 8, 10 weeks, whatever it is going to be.

It is true that we did not begin these hearings with an extensive laundry list of documents we expect to go forward because we do not know what we are going to need or not need as we go, in my view. Some of my colleagues differ with me and they wanted to have, as you know, the laundry list up front and I am not sure that our plan to approach to this subject was going to require that kind of demand. But it is clear to me that, as we get into this subject of specific areas and analyze some of the individual cases, we are going to want to review some Justice Department materials.

I know the chairman and I know Senator Grassley and I know Senator DeConcini have had experience through several administrations of on occasion having difficulty getting documents that they have felt at least—and just so it is not all you, I mean I remember the exasperation the Senator from Utah had with the Carter Justice Department.

Now, what I would like to know is: I am going to ask you first, can you set out in broad or as specific terms you can what is the Department's policy on supplying documents to this committee is or is going to be, or is that too broad an inquiry?

Mr. JENSEN. Well, it is broad but let me give you—we can discuss it and perhaps it would be even helpful that we play it through with specific contexts.

Senator BIDEN. Good.

Mr. JENSEN. But there is a threshold obviously that I think is understood by the committee. If we are in a situation where we have pending investigations, we are loathe to share, and we really will not share, the documents of pending live investigations. What we are looking at and what has been said here I think is to look at cases that are now closed and that is a totally different situation and we can now go back and look at them.

Within any closed case, you have got issues like this: There are 6(e) kinds of materials that are protected by that rule and we need to now assert that 6(e) rule and we think that is a limitation on the provision of documents.

Senator BIDEN. Let us talk about the rule 6(e).

Mr. JENSEN. That is the grand jury secrecy. It says that the documents that are provided to the grand jury are not available. They are protected by 6(e) and in order to get to documents within that category what we have said on other occasions to other committees was if the committee wishes to go to the court we would be happy to go with the committee to court and seek a court order to have that document produced. But really, it is a document that is protected by that rule and it is within the protection of the court?

We find ourselves in the uncomfortable position of being asked to produce a document that could put us in contempt of court if we provide it. We need to have a balance on that and that would be a mechanism where we simply go to court if it is a 6(e) document.

If there are documents that involve the revelation of the names of informants, for example, something of that nature that has either investigative or privacy interests, we would try to make accommodations so as to protect that interest but you would get the information that is underneath it. So there may be areas where documents are redacted or you get pieces of documents. That protects interests that have to do with investigative interests such as informants.

Senator BIDEN. Give me another example besides informants. The informants, I can understand, but——

Mr. JENSEN. Well, there may be a technique or there may be something that fits into this concept of the mosaic where there is a piece of information that is going to put us in a position where we have revealed something that is within a larger mosaic.

What we generally can do in situations like that is to protect that piece of information that we see as a part of a mosaic we need to protect but provide you the information. Generally, we can provide you the information in another form, so I think we can probably get to a resolution by having agreement upon the form in which the information comes to you. Sometimes that is the issue.

So we have a 6(e) problem, we have an investigative integrity problem, and then beyond that, we have a massive kind of document-handling problem. As I said, a lot of these cases are enormous paper cases and they have huge volumes of documents and they take a lot of effort on both our parts. We would like to be able to work out as efficient a way as we can, you know, where you want to go and we let you look at the documents and then make an assessment as to what you want, rather than produce a whole bunch of documents that you are going to have to go through. We spend an awful lot of time in just replicating the documents or reproducing them.

What we would like to do is to work out methods where you look at the documents and make specific assessments about what you would like to have and then we discuss the production of the document that has been identified.

Senator BIDEN. Let me speak with you about—the rule 6(e) situation—it seems pretty clear to me—let us talk about pending cases. I have a feeling that the definition of pending and open and closed cases, is not really open and closed. Let me give you an example.

How do you feel about cases in which there are no pending criminal investigations or indictments but there could be pending civil actions? Is that one of those things as a pending case, that there is nothing that we could ask you for in that, where there is no pending criminal indictment or prosecution?

Mr. JENSEN. There is an issue in terms of the pending civil case also. I think it is of a lesser order and I would think that we might be able once again to get at the information in such a form—in most of those kinds of instances where we are having follow-on litigation, where we are doing civil litigation of the previously litigated criminal case, there is a great deal of public record that is avail-

able and probably the public record that we can get to would be sufficient to satisfy whatever needs you have.

Senator BIDEN. Well, how would the case where, for example—I will try to narrow this down so we know where we are going to fight if we do—how would you view the General Electric timecard case which emanated out of Philadelphia? There is a case where the company pled guilty, paid a fine, and the individuals who were charged have already been tried, but somebody else could bring a civil action, there still may be——

Mr. JENSEN. No, we would deem that to be a closed case. If we do not have—when I say pending case I mean a case that is being brought by the Government, the Department of Justice, either in an investigative posture or in a litigation posture.

Senator BIDEN. Sometimes you all use the phrase "active investigation" or "pending case." In the case, for example, of investigation of General Dynamics, the grand jury looking into General Dynamics with regard to the construction of the Los Angeles class submarine was curtailed for at least 2 years and then it was started up again. Now, how do we know what you consider to be closed investigation when no prosecution has immediately resulted. In other words, if we had asked you after you shut down the investigation in the sense that nothing happened in 2 years, you know, because some of these folks, let us face it, have been under investigation off and on, I mean you can either take GE back in the sixties or the Teamsters, they have been like an open file.

Mr. JENSEN. Well, we would not approach that—the entity like that. There are discrete cases in that we would approach as closed. Unless there is a necessary linkage with some other investigation that is alive we would deem that to be a closed case. There may be an investigation of an entity without—I just use this as an example, we may have a GE investigation going on of a component of GE at some place in the country, but that does not mean we would not say the Philadelphia case is not closed.

But what happens is, and I think that this is something that has to be borne in mind, when we say open and closed, we mean that based on the present state of our knowledge and information. This is a state of what we have accomplished by investigation, either in terms of witnesses or documents, that this is as far as we could go. We say that, too, when we either have taken prosecutive action or civil action or we say it is closed. We are not going to take any more steps. Then 2 weeks from now we get new information. So it does happen that a closed case is suddenly an open case.

Senator BIDEN. As I understand it, the Department has said that you consider the *Sperry-Univac* case involving improper labor charges billed to different Air Force contracts as a closed case. Let us use that as a prototype for a second. First of all, is that a closed case, to the best of your knowledge?

Mr. JENSEN. I believe so, if we are talking about the same case. I would——

Senator BIDEN. Let us assume we are talking about the same case and if it is not you can clarify that for the record. In that case, assume it is closed, would we be able to look at—if it was relevant and we so requested, would we be able to look at all of the prosecutors' memoranda relating to that case?

Mr. JENSEN. In terms of the prosecution memorandum, we would like to talk to you about the memorandum in terms of whether or not it implicates other interests. Sometimes we redact them so badly that we do not even know what is there. It is also a part of a deliberative process that basically we would like to keep away from—I would say unnecessary scrutiny, but I do not mean to be——

Senator BIDEN. I understand what you are saying.

Mr. JENSEN. I think in the area where we have the flow of recommendations by the lawyers who are talking, we want to make that as healthy a discussion as we can and we like to keep that in such a fashion that those kinds of recommendations that are coming through are ultimately ones that result in final decision. We would like to discuss with you the final decisions, rather than the deliberative process. In some instances you may want to get into that and I think that there are areas where we can accommodate that.

Senator BIDEN. Just to make the point, one of the processes of this hearing—we are not like the Roth committee or the Hughs committee looking for a smoking gun. If we find a smoking gun, we will say there is a smoking gun, but part of this is process and when you make recommendations to us about whether or not we should move the law or change the law or leave it alone, making your case that the law is deficient or insufficient, that you are doing the job or you are not doing the job, we need to be able to effectively have a basis upon which to make a case study of that. So I would hope that if we do get to the point where in a close case we seek prosecutorial memoranda, that the rationale for our seeking it might persuade you that it is not worth a dogfight over, that it is our only way to look inside, if you will, the organization to cooperate, if you will, your rationale for the point you have arrived at, not whether or not you should have prosecuted, not whether or not that particular case is a good one or a bad one.

You know, things like reports and memorandums concerning investigative plans on the *Sperry* case or a similar case that is closed, are those kinds of documents ones we could get?

Mr. JENSEN. I would think so. They were doing this in terms of trying to—as I said, the best way to do it is to talk and see if we are really providing the information that you have to have.

Senator BIDEN. Right.

Mr. JENSEN. In terms of, say, the decision as to what was your rationale, in many instances we can provide that in a form from the policy level people who were a part of that process and they can do that.

Senator BIDEN. This is going to sound so fundamental, to state the obvious. Each of us has a separate role—this sounds so pendactic—each of us has a separate role in this Government. Part of ours is to oversee you all, and to not accept your stated summary of what in fact was the rationale if the material that confirms what the rationale is in place. It seems to me that we do not have to be accusatorial to adopt that position because that should be where we should be, it seems to me, our role.

Mr. JENSEN. I do not quarrel with that.

Senator BIDEN. OK. I just want to make——

Mr. JENSEN. What I think we need to say is that there are some levels in terms of the way in which that kind of mixture of responsibility is played out. There are some areas where we frankly feel that there have been some situations where undue kind of pressure has been put on line lawyers who are just simply asked to make the best possible judgment as professionals and that they suddenly find themselves in a mix of oversight that is very uncomfortable for them and for the process.

Senator BIDEN. Well, you know——

Mr. JENSEN. And I think that is——

Senator BIDEN. I understand that and it may be, it may turn out, Lowell, that it is uncomfortable. For example, if the rationale for making—let me just make a case. I am not suggesting this is the case, but let me just off the top of my head give you an example of what I am driving at.

Let us assume that the rationale for the organization of a particular aspect of the white-collar crime unit, the defense fraud section is that it makes a lot more sense for people at the threshold level to be able to have the authority to cut or move. Now, let us assume that is a management decision that is made.

Now, it seems to me it is appropriate for us to be able to know the rationale upon which that individual decision was made in a particular case, to determine whether your judgment was correct. It may be that at that level, to overstate the case, it may be that we find by looking at a number of cases that on balance, first-, second-, third-, fourth-year prosecutors are not competent to do that. It may be like a bank case. Banks started off 20 years ago and said loan officers should not have authority beyond $5,000. Other banks said they should have $1 million. Well, by trial and error they figured out that on balance the folks should get out of MBA schools, that you are going to make your bank loan officers, you really should not give them loan authority over such an amount or you should. Now, that does not mean that the bank had some kind of conspiratorial initiative to say we are going to let the line officer make the decision up to $1 million, because 20-line officers made 18 bad decisions that in fact it was the desire to defraud anyone.

So that is the reason why I hope you will think about the necessity of us to in fact determine whether or not the judgments you or any other Justice Department leadership make about the dispensing of authority, and that is why, for example, it would be useful for us in my view to be able to see recommendations for or against prosecution.

Admittedly, it may put, you know, that young—you know, when I got out of law school if I had had better marks and been smart he may have hired me at the Justice Department. Now, it may or may not be—I do not want to be the young guy just out of Syracuse Law School who is given the authority and I find out the first memoranda I write for the Justice Department suggesting moving forward or dropping prosecution turns out to be the focus of a Senate investigation. I sit there and you sit there and say, man, am I going to ruin this young guy's career or this young woman's career.

Well, maybe the way for us to deal with that is strike the young person's name, but I hope you understand why it may be completely relevant and necessary in our oversight function to literally get

65-428 O - 87 - 4

that initial memorandum without it being your characterization of what the memorandum says.

Mr. JENSEN. I can understand that and I think that, without agreeing on any specific prosecution memoranda or whatever we want to call them, or a specific document, is that we would understand your oversight responsibility to get behind the rationale.

All I am saying is that there is a concern that we have in terms of the management of the Department, the lawyers, and that we would like to be able to make sure that you understand our articulation of that. I think we can probably work out an accommodation. Now, it may very well be that it is not necessary to have a specific form of a memorandum or a document, that we may be able to do everything you need and also protect our interests, because there are some very real interests that are there in terms of protecting the professional judgment and making it as clean and as objective as we possibly can get.

Senator BIDEN. I have trespassed on your time long enough. I have about another eight or nine questions and I will submit them for the record. They will be helpful for us as we pursue this. My objective here, and I hope that I have over the years of this administration demonstrated some good faith, notwithstanding my on occasion harsh criticism of the leadership of the Justice Department and certain policies, but I hope we approach this whole thing with the notion that we are in this together and there is not, at least as it comes from the chairman and I, Chairman Thurmond and I, that you are willing to accept on its face, at least start off with that, that our inquiry is and our request is for the stated purpose, and the tendency I think in the four administrations I have had the pleasure of dealing with—it is hard for me to believe that I have been here long enough to have served under four Presidents of the United States of America.

The tendency down there is for some young lawyer or old lawyer to say, ah-huh, they only want to know what color the folder or the sheet is or the color of the folder for the document, but really what they are looking for is to find out whether or not I had a three-martini lunch. I hope we have established that with you all and I think we can work cooperatively on this.

From my standpoint, there is no hurry on the answers to the questions. This is going to be done thoroughly and not leisurely but thoroughly, and it is not going to close for at least the next couple of months, but I look forward to your answers.

Thank you, Mr. Chairman.

[The prepared questions of Senator Biden follow:]

[Answers not available at press time]

STROM THURMOND, SOUTH CAROLINA, CHAIRMAN
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DEBORAH G. BERNSTEIN, CHIEF CLERK
MARK H. GITENSTEIN, MINORITY CHIEF COUNSEL

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510

March 11, 1986

The Honorable D. Lowell Jensen
Deputy Attorney General
U.S. Department of Justice
Washington, D.C. 20534

Dear Mr. Jensen:

At the conclusion of our first day of hearings on White-Collar crime, you consented to answer for the record several additional questions to be submitted by letter.

In the 1980 Attorney General's Annual Report (ii) it was noted:

> For the purpose of gathering and analyzing information concerning White-Collar crime activity, the criminal division...accepted the working definition of White-Collar crime endorsed by the Attorney General's White-Collar Crime Committee in early 1977: 'White-Collar offenses shall constitute those classes of non-violent illegal activities which principally involved traditonal notions of deceit, deception, concealment, manipulation, breach of trust, subterfuge or illegal circumvention.'

You did not specifically use this definition in your testimony. Have you changed your working definition?

Would you agree that we need a clear and concrete definition -or related definitions- of a problem so that research, legal responsibility, sentencing, and policy review and evaluation can go forward?

Need the definitions for each purpose be precisely the same?

Assuming that different definitions might be better suited for different purposes, what different elements in the definitions should we emphasize in each of these areas?

II

Would you give us the Department's best estimate of the economic impact of White-Collar crime on the nation?

Would you break down that figure into its component parts?

-environment fraud or toxic waste
-drug fraud
-price-fixing
-insurance fraud
-securities fraud
-commodities fraud
-bank fraud
-defense fraud
-tax fraud
-money laundering
-health care fraud
-bankruptcy fraud
-bribery
-consumer fraud
-embezzlement
-record and tape piracy

Please include any other major areas that you believe necessary to complete the overall estimate.

Please indicate how you arrived at the estimate and what degree of confidence we ought to place in it.

III

Do you think that the Department's organization structure could be improved to deal with White-Collar crime? If so, how?

Have you considered whether or not the Department might be well advised to move to a more functional division of its work in the White-Collar crime area, that is, instead of placing responsibility in a Criminal or Civil Division, to organize it more like the Anti-Trust or Civil Rights Division?

Do you think, for example, that entrusting white collar litigation to criminal prosecutors will ever be compatible with vigorous civil action?

IV

Does the Department have a general strategic plan that goes beyond the setting of priorities to deal with White-Collar crime?

In that regard, what is the function of the Economic Crime Counsel? How often has it met? What recommendations has it made? Has its recommendations been implemented? How?

V

Should we make an effort to facilitate the greater integration of the criminal and civil litigation processes?

What has the Department done, for example, to implement the multiple fine provisions of Fine Enforcement Act of 1984 and the restitution provisions of Victim and Witness Protection Act of 1982 in the White-Collar crime area?

In that connection, would you provide us with any communications that you have had with the prosecutors in the field explaining or urging the use of these provisions?

Would you provide us with any data that shows how the provisions are being used?

Do you think that comprehensive or global settlements of criminal and civil litigation is in the public interest?

Are follow up efforts made to check to see that such settlements are lived up to?

Would you provide us with the details, for example, of what has been done to follow up on the Bradford National settlement (United States v. Bradford National (S.D.NY 1981)?

Your testimony before the Committee on February 27, 1986, materially contributed to its work. I look forward to your answers to these additional questions and your continued cooperation with the Committee.

Sincerely,

Joseph R. Biden, Jr.
Banking Minority Member

Senator HATCH. Thank you, Senator Biden. Thank you, Mr. Jensen. I will put my statement in the record at the beginning of the transcript.

We want to thank you for your forebearance.

Mr. JENSEN. Thank you.

Senator HATCH. You have been here so long and we appreciate the manner in which you have conducted yourself.

Mr. JENSEN. I appreciate the opportunity of being here very frankly and working with the committee and we look forward to seeing you at the end.

Senator HATCH. We sure do. With that, we will recess until further notice.

Thank you.

[Whereupon, at 3:55 p.m., the committee recessed, to reconvene subject to the call of the Chair.]

# WHITE COLLAR CRIME--PART 1

TUESDAY, MARCH 11, 1986

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
*Washington, DC.*

The committee met, pursuant to notice, at 1:38 p.m., in room SD-226, Dirksen Senate Office Building, Hon. Strom Thurmond (chairman of the committee) presiding.

Also present: Senator Biden.

Staff present: Michael Regan, staff counsel; and G. Robert Blakey, minority special counsel.

## OPENING STATEMENT OF CHAIRMAN STROM THURMOND

The CHAIRMAN. The Committee will come to order.

We will continue the series of oversight hearings on white-collar crime. This afternoon the committee continues this series.

We have a distinguished group of witnesses who have researched and written extensively in the area of white-collar crime. They should provide the committee with an overview of the history and some contemporary examples of white-collar crime.

Their testimony should help us to gain a further insight into this complex area and refine our definition and understanding of this subject. The statistical information which the witnesses will cite should aid in our efforts to appreciate the dimensions of the problem of white-collar crime. And we look forward to their testimony.

I believe our first witness today is——

Senator BIDEN Mr. Chairman.

The CHAIRMAN. Oh, excuse me.

The Senator from Delaware.

Senator BIDEN. Mr. Chairman, I ask that the entirety of my statement be put in the record and will summarize it very briefly.

Gentlemen, welcome to what has been characterized as a dull set of hearings thus far. But they are dull by design. We have embarked on what is in the minds of some not a long standing Senate tradition. We have been interested in getting the facts before we make judgments, and you all are part of, as the chairman suggested, our effort to more fully understand and comprehend the dimensions of the problem we are attempting to deal with.

This is not a series of hearings designed to find out "who done it" at E.F. Hutton or General Dynamics of GE, or any number of places in companies we could or could not name. But to get your notion of broad overview.

And I must say, Mr. Chairman, I think we have before us four of the most distinguished people in the country. They are capable and

completely competent to speak to the subject of white-collar crime. I have an opening statement. It says nice things about each one of you. Can we stipulate that we will send you a copy of the record, assuming the chairman allows it to be printed.

Gentlemen, seriously, welcome and we are anxious to be educated and that is the reason why we have asked you all to come. I thank you for your presence and look forward to your testimony.

[Prepared statement of Senator Joseph R. Biden, Jr., follows:]

OPENING STATEMENT OF SENATOR JOSEPH R. BIDEN, JR.

Mr. Chairman, I am pleased that we are today continuing our examination of white-collar crime and that we have such distinguished witnesses to build on the excellent record we established in our opening hearing, in which the Department of Justice shared with us its understanding of white-collar crime, its scope, its impact, and the Department's own investigative and prosecutive priorities.

Our task is to evaluate the Department's program and to see if it can be improved or strengthened. We need the best possible information and thorough analysis we can get. We must now begin to put the Department's program into a larger perspective.

Our first witness, Dr. Stanton Wheeler, who was, until recently, the director of the Yale Studies on white-collar crime and a professor of law at the Yale Law School, is in a unique position to start that process. Dr. Wheeler headed up a U.S. Department of Justice's National Institute of Justice project that conducted a series of empirical studies of various aspects of white-collar crime. Unfortunately, little sustained or empirical work has been done since Prof. Edwin H. Sutherland in his book, "White Collar Crime," first introduced the concept of White Collar crime over 40 years ago. Dr. Wheeler and his colleagues attempted to get beyond the headlines and general theory and obtain hard data.

I look forward to Dr. Wheeler's description of the results of the Yale Project.

I am just as pleased that our second witness will be Dr. Donald R. Cressey, a former dean at the University of California at Santa Barbara. Professor Cressey was a student of Sutherland and continued his impressive work in the publication of 10 or more editions of Sutherland and Cressey's, standard text,"Criminology." In 1953, Dean Cressey also published his own original White Collar crime study, "Other People's Money: A Study in the Social Psychology of Embezzlement," which, like Sutherland's work, is now considered a classic.

Not only is Dr. Cressey one of our Nation's leading experts on white-collar crime, he is also one of it's most knowledgeable students of organized crime.

We welcome Dr. Cressey.

Our next two witnesses are of no less importance. Dr. David J. Cherrington, who is a professor of organizational behavior at Brigham Young University, was the coauthor in 1982, with four of his colleagues, of an impressive text, "How to Detect and Prevent Business Fraud." Dr. Cherrington, and his colleagues, with the financial support of the Peat, Marwick, Mitchell, & Company Foundation, did a 3-year study of fraud that included no only extensive personal interview, but a complete literature survey. Indeed, it is their estimate of a $200 billion price tag for fraud that is the most widely quoted today, although they are the first to acknowledge that such general figures can only be ball park "guesstimates."

Our next witness, last in order, but not in importance, is Dr. Kenneth Carlson of ABT Associates of Cambridge, Massachusetts. Dr. Carlson and his colleagues recently completed for the Internal Revenue Service a comprehensive examination of the flow of illegal income in the United States. In addition to looking at the figures for drugs, gambling and other organized crime related offenses, they also looked at areas of more immediate concern to us in these hearings: They put, for example, Medicaid beneficiary fraud at $1.2 billion; Medicaid provides fraud at $715 million; and Medicare fraud at $1.5 million.

I look forward to hearing from Dr. Carlson on how much estimates are scientifically made and his assessment of the degree of confidence policy makers can have in them.

Thank you.

The CHAIRMAN. Now, the witnesses here this afternoon are Mr. Stan Wheeler, Yale Law School professor, Ford Foundation profes-

sor of law and associate of sciences, and author of numerous articles on white-collar crime.

Mr. Wheeler, glad to have you with us.

Mr. WHEELER. Thank you very much, Senator, it is a pleasure to be here.

The CHAIRMAN. The next is Donald R. Cressey, University of California at Santa Barbara professor of sociology. He was an assistant to Edwin A. Sutherland, the man who coined the term white-collar crime in the 1940's and is considered the first authority on the subject. Mr. Cressey is a leading academic spokesman on the subject. Glad to have you with us Mr. Cressey.

Mr. CRESSEY. Thank you, happy to be here.

The CHAIRMAN. Mr. David Cherrington, professor in the department of organizational behavior at Brigham Young University. He is the coauthor of "How to Detect and Prevent Business Fraud," a book written through a grant from Peat, Marwick, Mitchell & Co., one of the big eight accounting firms.

Glad to have you with us.

Mr. CHERRINGTON. Thank you.

The CHAIRMAN. Mr. Ken Carlson is principal author of "Unreported Taxable Income from Selected Illegal Activities," prepared at ABT Associates under a contract with the Internal Revenue Service. We're glad to have you with us.

So we'll now proceed. I guess, Mr. Wheeler, we'll take you first. You can present your statements or put your entire statement in the record, if you have a written statement, and just give us a summary—the thrust of your statement.

Mr. WHEELER. Fine. Thank you.

**STATEMENTS OF STAN WHEELER, YALE LAW SCHOOL, NEW HAVEN, CT; DONALD R. CRESSEY, UNIVERSITY OF CALIFORNIA, SANTA BARBARA, CA; DAVID CHERRINGTON, BRIGHAM YOUNG UNIVERSITY, PROVO, UT; AND KENNETH E. CARLSON, ABT ASSOCIATES, CAMBRIDGE, MA**

Mr. WHEELER. Time is short so I'll get right to the point. Over a 6-year period a number of lawyers and social scientists at Yale Law School were involved in a collective effort to understand more about the nature of white-collar crime—and especially about the handling and processing of defendants through the Federal criminal justice system. In the next several minutes, I'll try to give you a broad overview of our work and our findings. I know that later in your hearings you will be learning about particular types of white-collar crime and I'll leave those particulars aside—although some of our own studies may bear upon them. But time doesn't allow that discussion today.

Let me begin by dealing with some observations on the nature of white-collar crime, or at least the nature of it as it can be seen from the study of convicted offenders in the Federal criminal justice system.

One of the major studies that we undertook was the study of eight major forms of Federal offenses, typically known as white collar—thought of as white-collar crime. And I'd like to just very,

very briefly tell you a few of the things that we learned from the study.

The basis for the study was a very close analysis of Federal presentence investigation reports for some—over a thousand Federal offenders for these eight offenses. The offenses just for the record include the following: anti-trust offenses, securities and exchange fraud, postal and wire fraud, false claims and statements, credit and lending institution fraud, bank embezzlement, IRS fraud and bribery. What we did was to examine very closely all the information in the record of the presentence report which contains, as you know, full information about the nature of the offense but also a great deal of information about the nature of the offender, and the following statements are based upon some of the general conclusions from that analysis.

The first is a simple one. White-collar crime—although the term sounds like it might mean a single homogeneous thing—even in Sutherland's day did not, as he knew—and certainly one thing is clear after reading hundreds and indeed thousands of these records is that it is anything but a homogeneous set of activities. Even in the Federal system you can consider these differences. They are crimes based essentially on collusion, as in the case of bribery. There are crimes of simple theft, as in the case of lower forms of bank embezzlements, simple takings. And there are a whole range of different kinds of frauds where a pattern of deceit and cover-up is the principal, sort of, pattern of illegality.

Within the category of collusion itself, you have things as different as anti-trust violations where the collusion is around price fixing and bribery itself. The result is that there is just an enormous variety and I think one has to think at the outset—if one is thinking about legislation—about that enormous variety and range and how it might affect the way one approaches the problem.

The second statement, or finding, I would say, has to do with the great ordinariness of much of the crime that we study. Most of us are familiar with the major cases that we read about in the press, and they are, indeed, very important. But if you study the records of convicted Federal defendants, what one is impressed about is the ordinary quality of many of their acts. They're not Teapot Domes and they're not the grand scandals. They're not the Franklin National Bank. They're not E.F. Hutton. They are ordinary plain old cases. For every big-time politician or judge, there are many smaller cases. You are far more likely to find the bribery statute used, for example, to prosecute an account for trying to bribe an IRS official, or a prisoner—a Federal law enforcement officer. And for every GE price fixing case, you are much more likely to find a local laundry industry or real estate group or building maintenance group who've conspired to fix prices in their locality.

What than, if anything, makes white-collar crime distinctive as a form of crime? I would stress, given the shortage of time, just two major characteristics.

One is that many of the white-collar crimes are embedded in organizations. They occur in the innards, as it were, of organizational life where detection is very difficult. They aren't occurring on the street as in muggings and so on, but they are occurring inside an

organization and it's very hard to pry open the organization to find out exactly what went on inside.

Second, they depend on their perpetrators occupying a position typically of trust. The person with a title is given leeway that one on the street doesn't get. These combine to give both insulation and freedom that occurs much, much less often than when one is dealing with street offenders or common-crime defendants than when one is dealing with white-collar offenders. In one of our studies, Mitch Roth and I titled an article on the subject, "The Organization as Weapon in White-Collar Crime," and our main thesis is that the organization is to white-collar crime what the gun is to common crime. That is, it is the form that enables large takings and large transfers of funds from one party to another.

The crimes that use organizational covers, as a rule, produce much more, many times, in illegal gains than those committed by individual defendants. This is true in a whole series of examples of which I'll just give you briefly too.

A doctor, on his own, can engage in Medicaid fraud or he can be part of a clinic that engages in it. The clinic operations are likely to be 5, 10, 15, or 20 times larger in size, using the organizational mechanism.

A fraudulent loan application from a Mr. Jones, versus the same from the Jones Corp.—in both cases you may have Mr. Jones simply telling a different story about who he is—is likely to net him five or ten times more. Indeed, we have one case in our files where exactly this occurs.

If we think we learn anything about new forms of the activity or at least forms that are more frequent now than they might have been in the past, it has to do with a form that is part of the result of the growth of governmental bureaucracy. There are many persons now in Federal bureaucracies in sort of gatekeeper roles, persons with sign-off power on checks and so on—not necessarily high up in the organization and not necessarily professionals with all that often connotes about trust—but lower level officials with access to vast sums of money. Again, for want of time, I'll simply give you one very brief example.

There was a VA Administration eligibility clerk, working with a real estate broker to defraud the VA of more than $2 million in fraudulent loans. Here's a person, an organizational insider, not a person of very high status but a person whose position in the organization gives him control of vast sums of money.

Our guess is that there are simply many more positions in society now, both in the public and in the private sector where that is true, than there might have been in the past.

Senator BIDEN. Doctor, is that the case in financial institutions as well; in other words the loan officer, who has the $100,000 limit, the guy making $25,000 a year and can loan up to a $1,000 without someone signing off—or whatever it is? Is that where more of it comes—more of the fraud?

Mr. WHEELER. I'm not prepared to say that more of it comes from there, I am prepared to say that there are more positions in this society now, where persons have responsibilities for that money and don't have the same level of responsibility in the organization that we use to assume they have if they were signing off.

Senator BIDEN. Thank you, that answers my question. Sorry for the interruption.

Mr. WHEELER. That's perfectly fine.

I'm going to bypass questions about the motivation of these offenders, save for one very brief observation—it's a very complex area.

One thing that appears fairly frequently in the materials that we've been looking at, is something that I would call fear of falling. There are a number of instances in these data of persons who were ambitious and aggressive and who started out a pattern of white-collar activity, certainly within the law. They then find that as a result of normal business reversals and so forth, they have what is commonly known as a cash-flow problem in their organization, but by then they're use to a lifestyle at a standard that requires more than they're bringing in, and in an effort to make up for that shortfall, on a momentary basis may begin to engage in a pattern of illegality that becomes a common one for them, almost before they know it. I simply say this because it is the case that not all of the persons that we're studying start out out of a pattern of greed or a plan to commit illegal acts.

Much more could be said on that question but I want to pass on now, very quickly, to the next stage in the process and to problems relating to prosecution and defense of white-collar offenders.

We have made a serious effort to examine closely the process by which prosecution and lawyers for the prosecution and defense counsel operate and work when they are dealing with cases of white-collar crime. And the same traits that make the offense hard to detect, often make it very difficult to prosecute; if it's hidden within an organization, it's difficult to find out what went on. It's particularly difficult to get evidence with regard to the intent of the defendants.

Our criminal law requires criminal intent; that's one of the most difficult things to find in many of the complex frauds that characterize white-collar crime. That's undoubtedly one of the reasons why in the *E.F. Hutton* case you find the prosecution of the corporation, but not of the individuals.

Senator BIDEN. I'm sorry, I beg your pardon. That's a very interesting point. I didn't hear the beginning of your point.

Mr. WHEELER. I'm making the general point that the characteristics of the law enforcement process that distinguish between white-collar and common crime at the prosecution of defense stage are some of the same ones that make it hard to detect white-collar crime in the first place, specifically if the crime occurs within an organizational context and you have to get inside the organization to find out about it. That makes for an added sort of layer of difficulty.

Second, there is the problem of what one might call the "diffusion of intent."

As you know, in our criminal law we require the showing typically of specific criminal intent and criminal responsibility. Oftentimes, in the offenses one looks at, you have a pattern in which A does something, B does something, C does something and D does something, no one of them is able to show to have had the requisite criminal intent when they did it, but the end result is an illegal

transfer, or what appears to be an illegal transfer of funds, from one party to another.

The problem of nailing down intent is very difficult in the criminal law—generally, it's particularly difficult, it seems to me, in these areas. One of the things that makes it so is another one of the major differences between white-collar and common crime.

In many common crimes there is a broken window, a broken safe, literally a smoking gun—something that you can point to immediately.

Many of the white-collar crimes that we've been studying begin with nothing more than a whisper of a suspicion of something wrong. There are some figures that don't add up in a budget. Or there's a peculiar tax return that looks like there might be something wrong with it. But you can't know at the outset, when you begin the inquiry, precisely what it is that's wrong. And this makes it very, very different from common crime cases. It makes it particularly different when one realizes that as soon as the defendant, or the suspect, becomes aware that he may be the subject of an investigation, he is likely to find a defense attorney. And that defense attorney is going to be involved in the case months and even years before there's an indictment.

Whereas in common crime cases the defense attorney typically isn't involved until his defendant is in jail or out on bail. The offense has already occurred, it's very clear that something happened, and then the lawyer comes in. In these cases the lawyer is in very early and the lawyer is helping negotiate the very facts that will be on the record to establish whether a crime occurred or not.

The CHAIRMAN. Mr. Wheeler.

Mr. WHEELER. Yes, Senator.

The CHAIRMAN. I have a nomination on the floor so, I am going to ask my able colleague here to take over now while I'm gone.

Senator BIDEN. And good American, too. I appreciate it.

The CHAIRMAN. I want to thank you gentlemen again for your testimony. And Senator Hatch sends his regards here to Professor Cherrington and says he hopes to see you while you're here.

Mr. CHERRINGTON. Thank you.

The CHAIRMAN. Thank you very much.

Senator BIDEN. And he wants to know about Brigham Young's record last year in football, why it wasn't the national champion—he meant to ask you that. I'll talk to you about that in my question-and-answer period.

Thank you, Strom.

Mr. WHEELER. I would just note that this is one of the most important differences in the defense of white-collar versus common crime defendants. And in one of the major pieces of work in our series of publications on white-collar crime, Ken Mann studies in detail defense counsel and develops what he calls the information control defense. That is the emphasis entirely is on the control of information: information in the hands of the defendant, information in the hands of third parties who may know what the defendant did, or information in the hands of the Government. And what you have is a complex battle over information on the side of the prosecution and the defense. And he outlines, in great detail, the

steps and strategies that defense counsel use in order to try to gain control of that information so that it cant't be used against his client.

Again in these cases—just to give one example that one can't go into in detail—you find the use of pretrial discovery in the subpoena in the case of white-collar crime—typically often with days for a defendant to decide how much he was going to turn over and the extent to which he's going to comply with the subpoena—versus a search warrant and a seizure of the evidence in cases of common crime.

Here are different strategies of law enforcement, different means of information acquisition—they tend to be used differently in the two different types of offense and they tend often, at least, to make white-collar offenses difficult to prosecute for that reason.

Senator BIDEN [presiding]. Professor, did you find there was any difference in terms of the intensity of the feeling of the aggrieved party to pursue the matter?

I find when I was a defense lawyer that one of the things I was most concerned about was how upset the victim was. The victim who got banged on the head—felt strongly about it—they did everything they could to put as much pressure upon—with good reason I might add—the Justice Department to move and pursue the case.

It seems to me, and I hope you'll all speak to this at some point—and maybe I'm jumping the gun in your testimony—that in certain types of white-collar crime where the corporate veil is not so thin but thick, there is ambivalence on the part of the corporation even if they have been the one defrauded, whether or not they wish to pursue with any vigor the culprit in the matter for obvious reasons. Their name in print—does that come up—that notion of any part of your——

Mr. WHEELER. That is not something we looked at in great detail but there are certainly instances where precisely that happens and it is the case—and this is another related finding—the vast majority of the victims in our cases are organizational victims. That is, one hears about and it does indeed happen: the poor retired couple who are swindled out of their last $10,000—those cases do indeed occur and they occur in our sample. But they don't occur nearly as frequently as the organization that is defrauded, either a governmental organization or a bank—a private entity, for that matter. And organizational victims abound in our study and their responses are indeed different depending on their circumstances.

I would note just one other thing and that is about the crucial role of defense counsel in these cases at time of sentencing.

In the normal picture of defense counsel in common crime cases, they're involved heavily in plea bargaining but they don't come into the case in the first place early and they are often not terrifically heavily involved at time of sentencing. White-collar crime defense counsel are very involved early, as I pointed out. They're also very heavily involved in sentencing, which is often a kind of relitigation of the basic facts of the case. And enormous sums of money are likely to be spent building up a record at time of sentencing, to try to influence the sentencing judge. Now, this is an important

part of the work that the defense counsel do. It's often very effective. It's often very expensive.

And this last point ties into the last point I would make about prosecution of defense, and that is the enormous growth of something one could call the white-collar crime defense bar over the last 10 or 15 years or so.

It's not an accident that that happened, of course. There's been more prosecution of white-collar crime beginning at some point in the 1960's and the rise of the "defense bar" is a natural response to that fact. The bar is often populated by persons who get their basic training as prosecutors, who know better than anyone else what moves there are that the prosecution is likely to make.

Let me turn now, very briefly, to Federal judges and to their judgments about white-collar offenders and offenses.

One of the other studies that we undertook was a very detailed sort of probing set of interviews with some 50 Federal district court judges. This now is confronting the judge with those cases who have made it through the system, through indictment and either trial or plea to conviction and where the judge must impose sentence. And our interest was in learning more about how judges reason about the sentencing of white-collar offenders. So we made this special inquiry with these 50 judges in detailed, sort of open-ended interviews and here's a synopsis of what we found:

Although there's a view of Federal sentencing as being in chaos and disarray, that is not by and large what we found. We were more struck by what the judges shared than by how much they differed.

Again and again, though in very different words, the judges came back to three underlying principles: One—and they would use different language to characterize it but the underlying principles are not new to us—has to do with harm, with seriousness of offense, with the damage that is done by the offense. Another has to do with—if you had to put a single word on it, I would choose the word "blameworthiness"—that is to access the offenders "blameworthiness," if you will. And a third has to do with consequences, with the effect of the sanction either on the society or on the offender or those in his immediate environment.

All three of these have a longstanding place in the Anglo-American legal system. The grading of offenses by seriousness is as old as the code of Hammurabi. The calculation of intent and responsibility lies at the core of our whole doctrine of criminal responsibility. And notions of sanctions meant to have a certain effect are certainly common to all of us in the system.

These get expressed repeatedly by different judges talking about different cases in different language, but they come back so frequently to these same three themes that we really think of them as three principles that judges tend to share—although, as I will note, they may rate them very differently.

This is not however, a simple echoing of legal categories. Oftentimes the category may begin with what is some thing that is embedded in the law but then will be elaborated by the judges as they build a concept, an expanded concept of seriousness or of "blameworthiness" or of consequence.

For example, seriousness is not just the amount of monetary damage in white-collar crime cases but the judges will talk about the complexity of the case. They'll say this was really a complex fraud and they'll think of it as a more serious criminal act as a result, even though our law doesn't typically have the category complex, at least embedded in the language itself.

They'll often attribute more seriousness to crimes that take place over a greater duration, crimes that take place over a greater spread of geography—across State lines and so on. Even those may or may not be formally built into the system.

On "blameworthiness," just to take one other example, the judge's thinking may begin pretty much where the criminal law begins, that is, with a serious look at intent. Did this person really understand that what he was doing was wrong? But it then is likely to move quickly from that to other things—what role did the defendant play in the offense: Were they central to it or were they merely peripheral to it? It may then move earlier in time, they move backward in time, as it were, to an earlier point and they ask what kind of a life this person was leading and what kind of a person they were. To quote one judge, this was a real bad guy, he had been bad throughout—and a part of the characteristic of "blameworthiness" that they're building in had nothing to do with the persons "blameworthiness" in connection with this particular offense but with the way in which he had led his life. On the other hand, if he had a distinguished war record or evidence of service to the community, then that would change his "blameworthiness" position as it were.

Senator BIDEN. It in turn changed the sentence?

Mr. WHEELER. Yes, and in turn it changed the sentence. Many of these factors are probably too complicated to talk about in detail now but all of these are things that relate to the sentence, either aggrevating it or mitigating it, at least in our study of the correlates of Federal sentencing—including things that happened forward in time, that is, between the offense and the sentence, evidence of cooperation, evidence of the show or remorse and so on, often add also, as does evidence of motivation. Did the person do it out of need or out of greed—to put it very simply.

The result is a kind of expanded portrait of "blameworthiness" that goes far beyond what the criminal law has built into it at its core, but has to do with common sense, moral reasoning and conceptions of what it means to lead an upright life or a not-so-upright one. And judges, time and time again, refer back to a variety of these different things—not all of them paying attention to the same ones. And some of them are certainly not ones again that are built into the criminal law.

Despite sharing these principles, however, it does not mean that the shared principles lead over to identical sentences in similar cases. There is agreement typically on which is the more serious offender but there is no metric. That is, one person says A's crime is more serious than B: A should get 3 years and B should get 1. And another says that A's crime is more serious than B: A should get 5 and B should get 6 months.

It's in that area, where there's disparity in sentencing, we would argue, not in the basic underlying principles, but in the detail of

the weights that are being placed upon them—and we think we do see in the sharing of these three general principles the possibility of building a somewhat more consistent base for sentencing. And that these other problems—that there is no metric—that there's no zero point, that people don't agree on which cases deserve jail and which ones don't, even though they can agree that one case is more serious than another. Those are the areas where the greatest difficulty in sentencing seems to lie.

Let me make just three quick further points on judges before finishing with a remark or two about patterns of sentencing.

One of the things that we found we came to characterize as the "paradox of leniency and severity," and it seems to come up very frequently in white-collar crime sentences.

On the one hand, says the judge, this person had a position in life of responsibility and trust and by virtue of that they should have conformed their conduct to the law, and, when they didn't, what they did is more serious than the same person doing it who doesn't have that position of responsibility and trust, and therefore they deserve a greater sanction. And that leads toward severity.

On the other hand, the same person typically has led a life of contributions to the community—typically a first offender, no prior criminal record. And all those things argue in favor of leniency.

And the judges worry long and hard about how to weigh one of these against the other. On the one hand, it will appear to the public that they will be sentencing perhaps too leniently if they give this person—who may have done a very severe act but done it for the first time—probation, when they might have given probation to the first-time thief or burglar. On the other hand, the person does have a position of responsibility and they are torn as to how much to weigh one of these versus another. And we see often in the cases, judges wrestling with this problem.

A second is the problem of empathy for the background that they know.

A number of judges, by no means all of them, will say that it is indeed difficult to forget the fact that when you see someone who's like yourself, you're more likely to say: "There, but for the grace of God go I." And a number of judges allude to this formally in their interviews with us, that is, they are aware of the fact that they can't——

Senator BIDEN. That's why women and minorities spend so much time telling us it's important for them to be on the bench.

Mr. WHEELER. It's an understandable reason.

But it does happen here and it's a possible source and a concern of possible bias in sentencing. The same judge who could really empathize with one offender but who can't feel the same way about an offender from a totally different class and ethnic background, may lean over backward perhaps to try to offset his biases. We don't have direct evidence as to whether they do or don't. But a number of them signal it themselves as a problem.

Finally, there's the problem of deterrents and how to handle it.

Deterrents is a subject that comes up very frequently, obviously, in the criminal justice system—perhaps particularly in connection with white-collar offenses, which are believed to be more calculat-

ed, more rational and therefore more deterrable than some other kinds of offenses.

Many of our judges did say that they were very concerned in making their sentences serve a deterrent purpose and they often try to anchor them in such a way that they'll have an effect on a particular occupational group.

They will sentence a veterinarian because there hasn't been a veterinarian sentenced for tax fraud in their area for a long time and they just know that veterinarians are doing something wrong out there, for example—and that's only one of a number of examples.

But for many of them, they will feel that they cannot sentence for deterrent purposes if they couldn't also justify the same sentence on grounds of seriousness or "blameworthiness" that I talked about before. That is, they will resist using deterrents if the only thing they are accomplishing is deterrence—they have to convince themselves that the person deserves it because of what they did or because of who they are, in order to justify using it for deterrent purposes.

Let me turn finally to patterns of sentencing. I mentioned earlier that we did this detail study of presentence investigation reports. Those were used to study actual sentencing patterns as well as to study the backgrounds of offenders, and the actual patterns instead of the judicial reasoning about sentences that I just reported on.

And the long and the short of it, I would say, is this: there is a broad consistency in what that sentencing data shows—consistency with what the judges said they did. Judges do take offenses seriously. One of the highest correlates of severity of sentence is the amount of money that has been taken—and other characteristics of offenses correlate highly with the sentence as well.

They aren't rewarding high-status people with lower sentences, at least among those who are convicted, although it may be the case that higher status people who are able to get the best defense attorneys, as we were talking earlier, may be less likely to be convicted.

If anything, our data would suggest that they are harder on them. But it's very difficult—this is an area that really lay at the core of our studies originally. And it turns out to be extraordinarily difficult to generalize about class differences or social class differences in sentencing.

To to give you an example of the difficulty—where you have both civil and criminal penalties, as is often the case in white-collar crime cases, and a relatively minor offense, those who can pay may suffer more severe sanctions than those who can't. That is, if there's something there, the prosecution may go after it and they may do it in order to stave off the possibility of a criminal sanction. Whereas if it's minor enough and the person doesn't have much, they may not be sanctioned at all or may get probation without any payments. There is evidence of that in the study that Susan Shapiro of the SCC did for us. And I think you may well be hearing from her at a later hearing.

For more serious offenses, on the other hand, the person who has a lot to offer economically may be able to pay his way in effect out of it in a way that those who don't have it can't.

At any rate, it is very difficult to generalize about equality in sentencing. You typically are comparing apples and oranges. You're comparing a petty thief caught for the eighth time with a bank vice president who never before has been involved in crime. There's little doubt, on the other hand, about the effects of the resources. It is our study of defense counsel that convinces us that it does indeed make a difference who the defense counsel is, and whether you can get the best defense that the law will allow or not.

That's it in a nutshell. I have not discussed three important works in our series, one being Susan Shapiro's, "Wayward Capitalist," which is a study of the SEC, another being Susan Rose-Ackerman's "Economics of Corruption" and a third being Michael Riesman's "Folded Lies," which is a study of transnational bribery. But those stories remain for some other day.

Thank you, Senator.

Senator BIDEN. Thank you very much. I have questions but I'm going to wait until the whole panel has spoken.

Professor, if you would go next.

## STATEMENT OF DONALD R. CRESSEY

Mr. CRESSEY. Thank you.

I want to talk about why white-collar crime occurs, not on a statistical level but on a personal, social—psychological level. I'm concerned with management fraud—only one variety of the many kinds of white-collar crime that Professor Wheeler mentioned.

There are two principal kinds of management fraud. One is crime against the company. Embezzlement and conflict of interest are the principal offenses in this category. The second kind of management fraud is crime committed on behalf of the corporation—restraint of trade, bribery violation of the pure air and water laws, violation of occupational health and safety laws, falsifying books and records, and so on. In my research work, I pay close attention to what Professor Wheeler called motivation. He made the point a principal motive in white-coller crime is what he called fear of falling. I will elaborate on that. Before I do so, however, let me say that I think that policy makers and others should pay more attention to society and culture as promoters of crime than they do. The tendency is to try to control crime by brute force rather than through scientific understanding. The Western World has reduced the incidence of tuberculosis, malaria, and other infectious diseases significantly. We have accomplished this by finding out what causes the ill and then intervening in the process by which it occurs. Sooner or later management fraud and, for that matter, ordinary street crime will be controlled by this process

I have a prepared statement which I'd like to insert in the record. Now, I will merely comment on parts of it.

Senator BIDEN. Your entire statement will be placed in the record.

[The following was received for the record:]

# Why Managers Engage in Fraud

By

Donald R. Cressey

Professor of Sociology, University of California, Santa Barbara; and President, The Institute for Financial Crime Prevention, Austin, Texas

The Western world has effectively reduced the incidence of malaria, tuberculosis, and other infectious diseases. It has done so by developing valid knowledge about disease causation and then using the knowledge in preventive programs for eliminating the causes. Sooner or later, street crime will be controlled by the same procedure. Management fraud, too, will decline in frequency and severity when we develop knowledge about its causes and then use the knowledge in prevention programs.

Given the present state of behavioral science and of politics, we must continue our efforts to reduce management fraud by the hit-or-miss punitive and defensive measures which have been so notably unsuccessful with reference both to street crime and to white-collar crime. These include punishing and incapacitating violators, minimizing trust and freedom by close surveillance, and barricading wealth with burglar-proof strong boxes, electronic locks, and tamper-proof computers. But when efficiency in reducing the incidence of management fraud becomes a high-priority societal goal, such programs of punishment and incapacitation will be supplemented, even replaced, with interventionist measures based on knowledge of why managers steal. Accordingly, the first step in a practical program for reducing the management fraud rate is production of better information about the cause of this kind of criminal behavior.

Scientists concerned with causation in other fields have made important contributions to policy. For example, public-health policies as well as personal-hygiene practices pertaining to malaria are effective because contemporary scientists and others understand what causes malaria. This understanding, in turn, rests on the shoulders of the nineteenth-century scientists who developed the so-called "germ theory" of disease, a set of propositions about the cause of infectious diseases.

Behavioral and social scientists are far from an understanding which would make it possible to control crime in this scientific sense. More specifically, criminologists have not developed an accepted general theory of crime causation comparable to the "germ theory" of disease, so have not developed generally accepted explanations of specific kinds of criminal behavior such as burglary or management fraud either.

Nevertheless, one body of criminological theory makes good sense of management fraud and other crimes. This theory, originally and usually called "differential association" but now occasionally called "social learning theory" as well, supports the notion that if management fraud is to be reduced significantly, the ethics of business personnel will have to change significantly.

The differential association principle tells us that individuals violate the law because their social world contains multiple moralities, not a single one. People promote the idea that crime and criminality are indecent, bad, immoral, illegal. If individuals were to associate only with this idea, they would commit no crime. But people also promote a whole host of ideas which justify and thus encourage criminality under certain circumstances. Because such ideas have over the years become ideologies which make crime and criminality somehow all right, even if illegal, learning to behave in ways that could land you in jail is as easy as learning to drive your car faster than 55 miles an hour. In other words, individuals associate differentially with the two kinds of values -- anticriminal and procriminal -- and how persons behave depends on which set has been dominant in their life experiences.

This basic principle of crime causation grew out of concern for trying to develop criminological theory that makes sense of the crimes of rich business executives as well as the crimes of poor ghetto dwellers. Three steps were involved, and all were taken by the most distinguished sociologist-criminologist America has produced, the late Edwin H. Sutherland of Indiana University.

First, Professor Sutherland coined the term white-collar crime to call attention to the fact that popular criminological theories are faulty.[1] Poverty, poor education, broken homes, and emotional

disturbances were said to be causes of crime, but Sutherland noted that corporation executives who violate the law rarely have such characteristics.

Second, Professor Sutherland reasoned that a good criminological theory would have to explain the crimes of the rich as well as of the poor, just as the "germ theory" of disease makes sense of illness in all social classes and localities. He therefore asked criminologists and others to take a closer look at the accepted understandings of why people steal, rob, murder, embezzle, bribe, fix prices, engage in insider trading, give and accept illegal kickbacks, file fraudulent tax returns and reports to the SEC, and so on.

Third, Professor Sutherland followed his own advice and, as a result, developed the differential association principle to explain all of this behavior, and more.

The continuing popularity of the idea that crime is caused by personal and social pathologies, especially emotional disturbances and poverty, attests to the fact that Sutherland's call for sound criminological theory was not heard, and still has not been heard, in some circles. More specifically, his theoretical work has gained widespread acceptance among criminologists and other behavioral scientists, but differential association is virtually unknown among governmental policy makers. Whatever the reason for this neglect, it is not that the principle is too abstract or difficult.

As is the case with all other theories in human as well as physical science, the details of the theory are quite complex. But the essence is so simple that anyone can understand it: Some people learn to become criminals in perfectly normal ways, regardless of their social class backgrounds or personality characteristics, just as they learn to become managers, lawyers, brokers, purchasing agents, accountants, dishwashers, plumbers, waiters, typists, janitors, or something else. White-collar criminals as well as street criminals should be viewed as conformists rather than as deviants because they have taken over behavior patterns that are dominant in their social worlds.

## Differential Association and Management Fraud

A number of studies have demonstrated the relevance of the

differential association principle to management fraud. Three of them are particularly pertinent because they document how learned attitudes about the nature of business and government lead inexorably to violations of law.

The first study pertains to crime committed against a company or the government, rather than on behalf of it. When the late Erwin Smigel, a sociologist who was Professor Sutherland's colleague at Indiana University, asked people whether they approve or disapprove of stealing from organizations under certain circumstances, he found morality to be associated with the size of the victim organization.[2] Thus, half his sample strongly disapproved of specified kinds of stealing from a small business, but only 34 percent and 31 percent, respectively, disapproved of stealing when the victim was a large business or government. When 212 persons were asked to choose the type of organization from which they would steal "if in need" and if they felt "they had no other choice," 30 (14 percent) refused to steal under any circumstances and three would not answer the question. Of the 179 who responded, 57 percent preferred to steal from large business, 30 percent from government, and 6 percent from small business. (The remaining 7 percent either did not distinguish between large business and government or did not differentiate at all.)

Most respondents based their choice of large business on the principle of lesser evil, feeling that stealing from big business is not as bad as stealing from small business because large business is impersonal, powerful, and ruthless. Most used language similar to that of a respondent who said, "Big business has tremendous capital, a part of which they've cheated from me." Some of those who preferred to steal from government used the "Robin Hood principle," some deplored the "socialism" of government, and some used other verbalizations which neutralize the immorality of stealing.

The second study, focussed as it was on violations of price-control and rationing regulations during World War II, is more directly related to management fraud because it deals with crimes committed on behalf of companies and corporations rather than against them. Marshall Clinard, a professor of sociology at the University of Wisconsin, documented the differential association

principle when he found, in essence, that businessmen violated the government regulations because they did not "believe in" them.[3] Put another way, they possessed verbalizations --learned from associates in their social worlds -- which made the criminal law seem irrelevant. A dislike of government regulation in general was joined with dislike for price-control and rationing laws in particular. The result was language which attacked the very legitimacy of government and which, therefore, made black market operations seem almost patriotic. The bureaucrats in Washington stood for socialism, the idea went, while landlords and meat and poultry dealers stood for free enterprise and the American way of life. Clearly, the idea continued, the government was considering as a crook every businessman who tried to make a profit; it was the government that was wrong, not the businessman. The late Senator Robert Taft of Ohio put the matter this way: "The attitude of O.P.A. [Office of Price Administration] today, as I get it from everybody who comes to me, is that the businessman is presumably a crook; that if he is trying to make a profit he is greedy."[4] The businessmen who entered the black market were persons who accepted and applied to their own conduct this notion that the "bad guys" are government lawmakers and the "good guys" are free-enterprise merchants.

The third study was conducted by Robert Lane, a political scientist at Yale. Professor Lane's analysis of crimes among New England shoe manufacturers also showed the important rôle that learned anti-government language and attitudes play in crimes committed on behalf of corporations by management.[5] In the eight New England communities studied, there were wide variations in the number of shoe firms violating labor relations laws. In Haverhill, Massachusetts, for example, 7 percent of the shoe manufacturers violated these laws, while in Auburn, Maine, a whopping 44 percent violated them. Familiarity with the differential association principle helped Professor Lane see that one of the reasons for the differences in crime rates was differences in "attitudes toward the law, the government, and the morality of illegality."

The shoe manufacturers who associated with people whose attitudes favored violation were more likely to break the law; those

who were isolated from these attitudes were less likely to become criminals. Associates' influence was evident even in the reading habits of the manufacturers -- those who violated the law had immersed themselves in a segment of the daily press so hostile to government that violation of the law seemed almost appropriate to them. Thus, even newspapers were sources of verbalizations that made crime "all right."

Professor Lane predicted, on the basis of such observations, that managers of companies located in bigger cities, with a cosmopolitan press, diversified social life, and greater tolerance for heterodoxy, would accept legal restrictions on entrepreneurship more readily than would small-town managers and entrepreneurs. This prediction was borne out; firms located in small towns violated the laws much more frequently than did similar firms located in larger cities. The small-town atmosphere, as compared to that of bigger cities, more frequently provided a rationale which made this crime seem reasonable, even patriotic -- government shouldn't tell people how to run their businesses; "that man" in Washington is no good; labor unions are corrupt, and so on.

## Why Managers Steal from the Firm

Like these three studies, my own research on embezzlement noted the importance of learned verbalizations in management fraud. Unlike the prior research, however, my studies went on to analyze systematically how these verbalizations "work" in individual criminal cases. I long ago showed that modern business can function only because thousands upon thousands of managers and workers are trusted by their employers.[6] For this reason, defense measures such as internal controls and audits must necessarily be so relaxed that business personnel are technically free to embezzle, thus betraying the financial trust visited on them. Why is it that some do so and some do not?

In seeking answers to this question, I spent almost a year at the Illinois State Penitentiary at Joliet interviewing embezzlers. Then I moved to California and talked to more embezzlers, those locked up in the Institution for Men at Chino. At this point I thought I had collected enough raw data, so I published some

articles based on analysis of the interviews.[7] But I got nervous when critics began pointing to a fact I already knew, namely that my sample of trust violators included only a few bankers -- this because bank embezzlement is a federal offense and all my interviews had been conducted in state prisons. Although I had collected and analyzed some bank fraud cases that had been written up by psychiatrists, sociologists, accountants, and even embezzlers themselves, I had no first-hand experience with bank embezzlers. So I took a summer off to interview all the trust violators, including bank embezzlers, who were confined in the United States Penitentiary at Terre Haute, Indiana.

From detailed study of my interview notes, which ran to hundreds of pages and involved over 150 embezzlers, I developed, after several unsuccessful attempts, a generalization which applies to all the embezzlers I talked to. It also applies to the embezzlers whose cases had been independently collected by others and written up in a manner such that detailed analyses were possible. Indeed, I see no reason to believe that the generalization does not apply to all embezzlers, although I realize that researchers should not generalize beyond their data. It seems reasonable, too, that the principle involved in the generalization, if not the generalization itself, can be used to make good sense of management fraud generally, including that involving crimes committed on behalf of an organization as well as that committed against a company. This because the theory is consistent with the more general differential association principle and, thus, has something to say about blue-collar crime as well as white-collar crime.

What I came up with is a theory that embezzlement involves a psychological process which, for analytical purposes, can be divided into three steps or phases:

1. The feeling that a personal financial problem is unshareable.

2. The knowledge of how to solve the problem in secret, by violating a position of financial trust.

3. The ability to find a formula which describes the act of

embezzling in words which do not conflict with the image of oneself as a trusted person.[8]

Unshareable Financial Problems.

People have unshareable financial problems if it seems to them that they cannot turn to ordinary, legitimate sources for sorely needed funds. To an outsider, the situation may not appear to be so dire; what matters is the psychological perspective of the potential embezzler. Because the trusted person cannot resolve a financial problem alone and, in embezzlers' words, is "ashamed" or "has too much false pride" to share it with people ordinarily available for help in financial matters, the problem must be kept secret. Long after I had developed my generalization I found an example of this state of mind in a newspaper letter to Ann Landers. The writer was a bookkeeper who had taken $75 from petty cash to pay some long-overdue bills. "I could have gone to my boss and received a loan for this amount with no trouble, but I had too much pride," she said. "My husband makes a small salary, and I was ashamed to admit that we were having a difficult time financially." The writer, who signed herself "Ashamed," had not been caught, was paying the money back, and was terrified that she might succumb to the temptation again.[9]

After I had hit on the idea that unshareable financial problems are at the base of trust violation, I tested it by questioning fifty embezzlers about an imaginary financial problem. I asked them to suppose that for some reason their fire insurance policy had lapsed and then, through no fault of their own, there was a short circuit in the wiring, or lightning struck, and their house burned down. The family lost everything in the fire. My question was, "Do you think that in a situation like this you would have been tempted to embezzle to get the money you would need?" Sixty percent of the embezzlers indicated clearly that the this situation did not seem to them unshareable, and that therefore they would not embezzle. Although no one used the word "unshareable," the reasoning is clear in responses like these:

Case 42. I don't believe I would. I think that in a case like that folks would have sympathized with me

and helped me out. There would be outside aid. But in my own case, they didn't know about it so they couldn't help.

Case 57. Well, I don't doubt that I would if I couldn't borrow the money or something like that. There are people or relatives that have money. I've never got along with them, but if it was a necessity like that I would go to them. I'd do anything to give my wife and children what they needed. [Earlier he had said that he had been too proud to go to relatives for help at the time he embezzled.]

The unshareable-problem motivation helps to make understandable the reported high incidence of "gambling," "other women," "improvident investment," "drink," "living above his means," "poor business manager," and so on in the life experiences of embezzlers, but these ways of behaving are not used as explanatory principles. None of these conditions are present in even a majority of trust violation cases, so the word "cause" is hardly applicable to them. But the unshareable-problem concept shows how various experiences, especially unsavory ones, might "work" to motivate embezzlement.

Perception of Opportunity.

Note that people do not embezzle just because they have unshareable financial problems. Most trusted persons, like everyone else, have such problems from time to time, but few violate their trust in order to solve them. Many do not reach the second step in the embezzlement process, the realization that the unshareable financial problem can be solved in secret by violating a trust.

The second part of my generalization is thus concerned with the trusted person's perception of opportunities to embezzle. Everyone in a genuine position of financial trust has hundreds of opportunities to violate that trust. That's part and parcel of being trusted -- if there is no opportunity for people to steal, it is meaningless to say that they are trusted. Despite this, many persons in positions of financial trust never become aware of the fact that trust violation can be used to resolve any unshareable financial problems they might have. Before they can note that such

an objective opportunity exists, they must possess general information about how trusts are violated and must be able to apply that general information to their individual circumstances. It's not very hard to do. Here is an illustrative statement, made by an accountant in response to a question about the techniques he used in his embezzlement:

> In my case, I would have to say that I learned all of it in school and in my ordinary accounting experience. In school they teach you in your advanced years how to detect embezzlements, and you sort of absorb it. . . . It is just like a doctor performing abortions -- I did not use any techniques which any ordinary accountant in my position could not have used; they are all known by accountants, just like the abortion technique is known by all doctors.

Neutralizing Verbalizations.

But the crux of the matter is in determining why some trusted persons perceive that they have an illegal opportunity to solve an unshareable problem by trust violation while others do not. The third part of my generalization about the embezzlement process takes care of that. After I had asked a few embezzlers to tell me how they got into such a mess, I began to note that they talked about how they had "kidded" themselves and "fooled" themselves into believing that their crime was somehow all right. More interviews and more study convinced me that the words available to a potential embezzler for use in conversations with himself or herself determine whether or not the person will perceive that there is an opportunity to violate his or her position of trust. Moreover, these words also, and at the same time, determine whether the trust actually will be violated.

I call these critical words neutralizing verbalizations. They make up the most important element in the process which gets a trusted person in trouble, or keeps the person out of trouble. If a man sees a possibility for embezzlement, it is because he has defined the relationship between an unshareable problem and an

illegal solution in language that lets him look on trust violation as something other than trust violation. If he cannot do this, he does not become an embezzler. If he can do so, trust violation is inevitable.

Recall, now, Erwin Smigel's discovery that people think it is not as bad to steal from the government as from a small company, Marshall Clinard's discovery that violators of price control and rationing laws do not believe in the laws, and Robert Lane's discovery that manufacturers who violate labor laws are hostile to the government enacting the laws. All three studies called attention to the important rôle that neutralizing language plays in law violation. My embezzlement studies went on to conclude that such neutralizing verbalizations are critical to trust violation, in the sense that the crime will be committed if the right language is available, and will not be committed if the actor cannot conjure up the right formula for neutralizing ideas about how trust violation is wrong, immoral, indecent, illegal.

Every trust violator I interviewed used a neutralizing verbalization. As predicted by differential association theory, trust violators apply to their own situations a set of words which their associates, past or present, have applied to the behavior of others and which, indeed, they themselves might have applied to the behavior of others. Each perceives that a general rule applies to one's individual case.

Trusted persons who embezzle small amounts over a long period of time almost invariably use a "borrowing" verbalization. Independent entrepreneurs, factors, and agents who convert financial deposits of various kinds usually use a rationalization which enables them to look at the embezzled funds as their own. Absconders, by way of contrast, almost always use a "don't care" or "to hell with it" verbalization which enables them to leave town with funds or property without giving up their ideal of honesty -- they view themselves as special kinds of criminals whose blatant law

violation is somehow justified, in the manner of terrorists and other political criminals.

Embezzlers report the use of other verbalizations, such as the notion that theirs is a case of "necessity," or that their families are in a precarious position, or that their employers are cheating them, but this language is almost always used in conjunction "borrowing," "ownership," or "don't care" verbalizations.

Note once more that vocabularies of motive are not something invented by embezzlers on the spur of the moment. They are learned, and are reflections of cultural ideologies pertaining to the propriety of committing crime under certain circumstances. For this reason, the neutralizing verbalization component is by far the most important of the three elements making up the embezzlement process. Further, the fact that verbalizations exist as group definitions of situations in which crime is appropriate makes understandable the behavior of most criminals, not just embezzlers. Among these are the corporation managers who steal money for their corporations rather than taking money from them, as embezzlers do.

## Why Managers Steal for the Firm

Management fraud committed on behalf of a company is, like embezzlement from a company, importantly determined by neutralizing ideologies which make it somehow "all right" to violate the law. At least three such ideologies are recognized by American business personnel. Significantly, they often are transformed into neutralizing verbalizations by business executives bent on increasing their corporation's profits through illegal or unethical means:

1. "Honesty is the best policy, but business is business."
2. "It is all right to steal a loaf of bread when you are starving."
3. "Governmental regulation of business is socialistic and counterproductive."

I do not maintain that these three verbalizations are literal examples of the words used by managers as they commit company fraud. They are not the same as the "borrowing," "ownership," and "don't care" verbalizations which neutralize the honesty of trusted persons

who embezzle. But I do say that, in the last analysis, the three slogans are the source of most neutralizing verbalizations used by corporation executives who violate the law and, sometimes, their own ethical principles in order to maximize their company's profits. "Business is Business".

It is not likely that Kahuei Tanaka, who resigned as Prime Minister of Japan after being accused of taking about two million dollars in bribes from the president of Lockheed, the American airplane manufacturing company, had an unshareable financial problem. It is likely, however, that if he accepted bribes he did so because he had learned that doing favors for businessmen is a routine part of politics, as is receiving a contribution in exchange for those favors. He could learn such an "everybody does it" verbalization only if it were floating around (in language) as a cultural ideology which makes bribe taking seem like something other than bribe taking.

Bribery, kickbacks, and payoffs have become part of the political and business culture. Such dishonesty has been around so long that it is considered the normal way of doing business. In some societies -- Mexico, for example -- corruption is so open and above board that it is not even taken to be corruption. In other societies -- the United States, for example -- corruption is more hidden and deplored, but it is customary nevertheless. Indeed, most American businessmen do not have to think twice about reconciling their rôles as trusted and upright citizens with their rôles as bribers and corrupters. The reconciliation was accomplished generations ago and then handed down as a way of life. An anthropologist has given us an example from another culture:

> The Burmese are Budhists, hence must not take the life of animals. Fishermen are threatened with dire punishment for their murderous occupation, but they find a loophole by not literally killing the fish. "These are merely put on the bank to dry, after their long soaking in the river, and if they are foolish and ill-judged enough to die while undergoing the process it is their own fault.". . . When so convenient a theory had been expounded, it naturally

became an apology for the whole guild of fishermen.[10]

Consistently, members of some American "guilds" are threatened with dire punishment for bribing politicians but their ancestors, like the ancestors of contemporary Burmese fishermen, found a loophole. They learned to call bribery "campaign contributions." Their descendants feel no pangs of conscience when they contribute funds to Political Action Committees, which turn them over to politicians. "The money is given to support politicians whose positions on the issues are the same as ours, and if our elected representatives favor us when they enact legislation or award contracts they do so out of consideration for the political principles that got them elected." Such a long-winded apology makes it unnecessary for contemporary business leaders -- or labor union leaders, for that matter -- to give any thought to the question of whether their behavior is illegal. It isn't.

But other apologies more clearly neutralize prohibitions against bribery and other crimes. These apologies function as ideologies and they make behavior somehow "all right" even if illegal. For example, among American corporation executives, and owners of small companies as well, unscrupulous and even criminal behavior is made rational by the first of the three main sources of neutralizing verbalizations. This is the ideology which begins and ends with the assertion that "Honesty is the best policy, but business is business." The last part of the slogan neutralizes the first. Any professor, priest, politician, reporter, or other "outsider" who has questioned business executives about business ethics has heard some variety of this cultural rule. The children and spouses of business managers must hear it voiced almost every day.

There is no need for documentation or even extensive illustrations and examples. Everyone knows "It's a jungle out there and you can't go by the book," as business personnel are inclined to put it. So far as price fixing and other violations of anti trust laws are concerned, there does not seem to have been much change

since 1947, when a member of the Federal Trade Commission said, "About the only thing that keeps a businessman off the wrong end of a federal indictment or administrative agency's complaint is the fact that, under the hit-or-miss methods of prosecution, the law of averages has not made him a party to a suit."[11]

That the "Honesty is the best policy, but business is business" ideology is common among business personnel is also evidenced by the fact that half the 1,700 corporation executives polled in one study agreed with the following proposition: "The American business executive tends to ignore the great ethical laws as they apply immediately to his work. He is preoccupied chiefly with gain."[12] In opting for gain ("business is business"), some corporation directors and managers occasionally use methods which are in direct violation of the law ("honesty is the best policy").

Necessity.

The second ideology, "It is all right to steal a loaf of bread when you're starving," is even more pervasive than the first. Every day, thousands of Americans -- white-collar and blue-collar workers alike -- apply some variation of this ideology to their own conduct. This because almost everyone subscribes to the popular but erroneous idea that committing crime or behaving unethically is all right if doing so is a "necessity." We learn this ideology at our mother's knees. Accordingly, those who later transform it into a neutralizing verbalization have a sense of support and approval.

Poverty does not cause crime. I came to this conclusion long before I became a sociologist or criminologist, and nothing in my professional experience has altered it.

Like other army airmen stationed in India during World War II, I saw the shriveled legs and exended bellies of a population undergoing a famine. Three times a day I dumped the left-overs of my mess kit into one of the aprons held out by the crowd of begging men and boys who cringed, bug-eyed, at the door of the thatched building which served as our squadron's kitchen and mess hall. There were no fights, no pushing or shoving, no arguments. After each meal, the gentle Hindus, most with empty aprons, retreated to the periphery of our camp, where -- with their mothers, sisters, wives, and children -- they quietly starved. I never heard of a

soldier being robbed nor, for that matter, of a theft. Some evenings, I walked alone to the edge of our camp, braving the hordes of pitiful beggars who engulfed me. I feared no evil. Somehow I knew that in this culture even famine did not have crime as a consequence.

A few years later, when I was snugly ensconced as a graduate student at Indiana University, I read a famous writer's account of the famine I had witnessed:

> Through all of these months the white Brahmin cattle wandered by the hundreds though the streets of Calcutta, as they always have, stepping placidly over the bodies of the dead and near-dead, scratching their plump haunches on taxi fenders, sunning themselves on the steps of the great Clive Street banks. No one ever ate a cow; no one ever dreamed of it. I never heard of a Bengali Hindu who would not perish with all his family rather than taste meat. Nor was there any violence. No grocery stall, no rice warehouse, none of the wealthy clubs or restaurants was ever threatened by a hungry mob. The Bengalis just died with the bottomless docility which, to most Americans, is the most shocking thing about India.[13]

Like the people of India living near Calcutta forty years ago, thousands of the poor people who are today experiencing the grinding poverty characterizing parts of Africa, Asia, and South America have not violated the criminmal law, and and will not violate it, even if starvation is the alternative. In the United States, similarly, not many of the people who go to bed hungry every night will steal to fill their bellies. Girls and women, for example, experience as much poverty as do males, but their delinquency and crime rates are much lower. Even a good percentage (no one knows exactly what the percentage is) of the men and boys living in the poverty-stricken ghettos of large American cities commit no robberies, burglaries, or grand thefts. And thousands of business executives whose companies are going under because the economy has collapsed will not cook the books or otherwise violate the law in a desperate attempt to

postpone the inevitable. People who take "Thou shalt not steal" literally are not people who steal.

What causes crime is multiple moralities, as Edwin Sutherland's differential association principle long ago insisted. Over the years, Americans and other Westerners have invented a lengthy list of verbalizations which many, but by no means most, citizens use to neutralize ethical admonitions as well as the prohibitions stipulated in statutes. Many of these ethical loopholes stem from the idea that it is not really wrong to steal when stealing is "necessary." The notion that poverty causes crime is but a variation on this theme. Poverty does not jump up, grab people by the throats, and force them to steal. But the idea that poverty causes crime is highly relevant to criminality and unethical behavior because it informs citizens about how they are "supposed to" behave when in poverty.

It is easy to see that among starving people those who have been reared to believe that "It is all right to steal a loaf of bread when you're starving" are likely to steal bread. It is more difficult to appreciate the fact that this ideology also works to immunize non-starving people from being terrorized by the criminal law's promises of punishment for anyone who commits a crime. It does so because the terms of the slogan are not to be taken literally.

If it is all right to steal a loaf of bread, is it not all right to steal other food? And if it is all right to steal food, is it not all right to steal money to buy food? Continuing, if it is all right to steal money to buy food, is it not all right to steal property to exchange for money with which to buy food?

And if it is all right to steal when you are starving, is is not all right to steal when you are hungry? When you are not hungry but don't know where your next meal is coming from? When you are hungry for heroin rather than for food? When your income does not permit you to replace your children's worn out shoes? Your own shoes? Your clothing? Your television set, refrigerator, or car?

Is membership in a country club not as necessary to some people as owning a television set is to others?

Like "starving," the "loaf of bread" in what might be called the "Jean Valjean principle" also is symbolic. It has been extended to rationalize the stealing of heroin, money, TV sets, and automobiles. "Loaf of bread" also has come to have equivalents in embezzled funds, the income obtained from price fixing, bribery, and fraudulent advertising, the profits from industrial pollution of air and water, and hundreds of other kinds of corporation profits which can be maintained or increased by management fraud.

In the business world, as elsewhere, neutralizing verbalizations transform the "necessity" ideology into individual criminal behavior. For example, a business manager who has learned that starvation justifies stealing and that, therefore, "poverty causes crime," is likely to have learned, also, that "People naturally steal when they get in a tight spot." This belief, in turn, can readily become a rationalization for a whole host of crimes committed on behalf of a corporation because it is in the manager's computer-like vocabulary and can be called up for use whenever the corporation gets into what the manager defines as a tight spot. To an observer, the "tight spot" might not be so tight. Like the unshareable problems confronting potential embezzlers, "tight spots" are subjective. Reductions in profits, failures to increase profits according to stipulated goals, and declines in proportions of the market with or without declines in profits have all been defined as tight spots. Once a situation has been so defined, it becomes the stimulus for use of verbalizations such as "It is all right to cut corners," "It's worth the risk," "I've got to be practical," "Everybody does it."

Something like this might have going going through the mind of Robert L. Crandall, president and chief operating officer of American Airlines, when in a 1982 telephone conversation with Howard Putnam, president of Braniff Airways, he suggested that law violation (price fixing) might solve the financial problems of both corporations. "I think its dumb as hell...to sit here and pound...each other and neither of us making a [word deleted] dime,"

Mr. Crandall said. When Mr. Putnam asked "Do you have a suggestion for me?" Mr. Crandall replied, "Yes, I have a suggestion for you. Raise your goddam fares twenty percent. I'll raise mine the next morning....You'll make more money and I will too." Although a judge ruled that the offer did not constitute an attempt to monopolize airline routes by conspiring to fix prices, as Justice Department officials contended, he added that Mr. Crandall's conduct "was at best unprofessional and his choice of words distasteful."[14]

Even more relevant to crimes committed on behalf of corporations is evocation of a "superior" ethic which justifies illegality. Here, the ethic embodied in criminal law is acknowledged and even revered, but it is neutralized by noting the dire consequences -- symbolically equal to starvation -- that will occur if the law is not violated. Most commonly, executives whose companies are in what the executives define as <u>really</u> tight spots argue, at least with themselves, that their company makes social contributions that must not be diminished. The company provides employment for hundreds of people. It makes products that people need or ought to need. Its employees contribute much to the local economy, as do its suppliers. It contributes to national defense. It is a source of income for thousands of shareholders. It makes significant contributions to museums, art galleries, symphonies, theater groups, the United Fund, and other charities.

For some business executives, bankruptcy or near-bankruptcy of a business that does good works while it makes profits is an unpleasant tragedy which everyone must face up to. Businesses fail, and sometimes they fail despite the best efforts of highly capable managers. That's tragic, but it can't be helped.

But for other business executives, the ones who become criminals, the social value of the corporation is paramount. The tragedy of its failure must be averted. Desperate times call for desperate measures. Because "It's all right to steal a loaf of bread when you're starving," fraudulent accounting in the form of false records of sales and profits is a reasonable response to recession losses, price fixing is a reasonable response to aggressive competition, and handing out kickbacks is a reasonable

way to increase the company's share of the market. "After all," the idea goes, such corner cutting measures "are only temporary." "Everybody does it."

More generally, the popularity of such language is quite relevant to understanding why so-called "pressures" for performance seem to lead corporation executives to sacrifice their personal ethics to profit making. Some organizational theorists use "pressures" as though something in the atmosphere causes people to commit white-collar crimes. Obviously, however, merely citing "pressures" does not really explain law violation. In human events, a decent explanation must provide information about why some people under "pressure" violate the law while others do not. The most relevant information about differences in tolerances for "pressures" is information about how people talk to themselves.

For example, Straw and Szwajkowski's famous study of violations of antitrust laws between 1968 and 1972 found an inverse relationship between what the researchers called the "munificence" of a corporation's environment and the likelihood that the corporation will be cited for restraint of trade.[15] The implied conclusion was that poverty ("pressure") causes crime. But no mention was made of the fact that executives of some corporations with "munificent" environments violated the law, while executives of some corporations without such environments did not. This fact needs explanation, and a reasonable one is that people possess varying ideas -- learned over the course of a lifetime -- about how one is "supposed to" behave when poverty strikes.

Similarly, Edward Gross, a distinguished sociologist who is an expert on organizational behavior, has argued that "pressures to do everything possible to keep the organization moving toward accomplishing its many goals" remain even when corporation executives find themselves "in hostile or difficult environments, surrounded by fierce competitors, or constrained by regulations which interfere with their performance."[16] Therefore, Professor Gross argues, the likelihood of law violation increases. Perhaps so. But if the likelihood does increase, it is not simply because there are conflicts between "pressures" and restraints. It is

because too many executives apply to their own situation the ideology that criminal behavior is all right when economic need is high.

Criminal Laws are Un-American.

Clearly, "It is all right to steal a loaf of bread when you are starving" supports criminal behavior among wealthy and powerful corporation executives, just as does "Honesty is the best policy, but business is business." An equally relevant ideology, also popular in our business subculture, is "Government regulation of business is socialistic and counterproductive."

My summaries of studies by Professors Smigel, Clinard, and Lane have shown how this third ideology spawns verbalizations which neutralize prohibitions against committing crimes on behalf of business organizations. Recall that Professor Smigel found some people believing that it is not as bad to steal from the government as it is to steal from a small business because the government is socialistic, that Professor Clinard found businessmen violating price control and rationing laws because they considered the laws to be socialistic, and that Professor Lane found anti-government attitudes to underlie labor-law violations. From these three studies alone it may logically be concluded, ironically enough, that America's cherished respect for individualism is directly correlated with her high crime rate. Each of the studies showed that our majestic love of individual freedom has a dark side -- a disrespect for the authority of government and, because government makes and enforces laws, a disrespect for law and order. More specifically, love of liberty makes it all right to violate business regulations if these regulations are perceived as socialistic, counter-productive, and, in the extreme, subversive.

Considerable additional evidence supports the conclusion that business executives, like political terrorists, violate regulatory laws and other criminal laws because they do not respect the government institution which has enacted and is enforcing them.[17] European terrorists are not flag-waving patriots. Like other contemporary terrorists, they equate capitalism with exploitation, and therefore deny the legitimacy of established government in capitalist societies. Sociologists and criminologists have known

for a generation that what motivates terrorists and militants also motivates white-collar criminals. Some businessmen have so little respect for law that they would prefer an antitrust indictment to being caught wearing argyle socks. They restrain trade and violate laws against fraud, tax evasion, political corruption, worker and consumer safety, false advertising, and pollution with impunity. They do so because they, like terrorists, deny the legitimacy of the government making and enforcing these criminals laws. Unlike terrorists, however, they think the government is not capitalistic enough. Like the meat producers and landlords who violated price control and rationing laws during World War II, they consider the laws unwise, counterproductive, and socialistic.

Even the first study of white-collar crime -- Edwin H. Sutherland's White Collar Crime, published in 1949 -- showed that some business executives become criminals because, like terrorists and other extreme radicals, they deny the legitimacy of American institutions. Professor Sutherland called these business leaders "subversive," an epithet applied in the nineteen-forties and early nineteen-fifties to liberals and others accused of Un-American activities. "If the word 'subversive' refers to efforts to make fundamental changes in a social system," Professor Sutherland said, "business leaders are the most subversive influence in the United States."[18]

Terrorists are not deterred by actions of a state they consider illegitimate. Closer to home, we all know that when crooked police officers work ghetto beats, inner-city youth learn that you go to prison because you cannot fix your case, not because you have done something wrong and deserve to be punished. The thing to avoid is not crime, but its punishment.

Some business executives, particularly some of those managing large corporations, think they are witnessing the same kind of government hanky-panky that ghetto youth think they see. The difference is that the executives are closer to the government they disrespect. There is a steady two-way flow of personnel, especially top-level personnel, between business firms and their legal representatives on the one hand and the government agencies which

police business on the other. Some governmental processes and agencies are dominated by the very people whose conduct they are expected to control. They sabotage what they consider Un-American interference with free enterprise. It is no wonder that some executives have little respect for regulatory criminal law, or that they seem indifferent to the punishments threatened for violating the law.

This lack of respect for regulatory law, like denial of government's legitimacy on the ground that it is socialistic, is correlated with the ideology of individualism, which had its origins in the commercial and industrial revolutions and the business-government machinations which ensued. As world commerce began to develop, so did a system of free economic competition. This system was spurred by Adam Smith's individualistic ethic, according to which social welfare is best attained if every person pursues only individual interests and greedily works only for personal gain. The American democratic revolution, whose leaders championed natural and inalienable rights, cannot be clearly separated from the economic and ethical revolutions which accompanied industrialization. As Smith himself pointed out, America's passion for the free market principle was fueled by attempts at business regulation by the British government.[19]

Despite the growing distrust of centralized authority stemming from Smith's individualism, the widening area of social interaction and the deadly effects of industrial competition led individuals and groups to appeal to government for assistance. In nineteenth-century America, as now, business executives publicly demanded free competition and cried out against governmental interference with it. But the welfare state bloomed as they discovered that in competitive efforts to acquire wealth, great advantages fall to those who can secure patents, tariffs, trademarks, and other governmental privileges which restrict competition. They therefore convinced governments to put restrictions on expression of what Adam Smith believed was the competitive instinct producing free

competition, free labor, and the free market. Smith, a champion of the people, saw this use of government as an expression of conflict between business interests and the public interest. First he noted that social class was involved: "Civil government, so far as it is instituted for the security of property, is in reality instituted for the defense of the rich against the poor."[20] Then he went on to argue that business interests were exploiting the public by introducing and enacting regulations which create loopholes in his "natural laws" of the free market economy.[21]

But more than "business versus the public" was involved as merchants and manufacturers pressed for governmental restrictions on competition. It soon developed that the industries securing the most restrictive political regulation of competitors and the most favorable government-granted opportunities for themselves -- contracts, grants, loans, and so on -- made the most money. In other words, in the nineteenth century it became obvious to businessmen and others that competitive advantages, not just deception and oppression of Adam Smith's "public," can be secured through governmental manipulation. Before long, the competition symbolized in words such as "free agent," "free enterprise," and "contract" (as opposed to "status") moved from the economic sphere to the political sphere.[22] New criminal laws and administrative regulations were enacted in an attempt to control personal behavior in a world of competing strangers, but the laws and regulations tended to receive support only from special interest groups. The result was the anomalous condition of a great amount of legislation and little respect for legislation. Each group rebelled against the legislation forced upon it by other groups, and in a competitive process each group attempted to secure legislation to regulate its competitors.

As a consequence, ethics became utilitarian -- that which corporation executives, robber barons, and pious old frauds could get Congress to outlaw was unethical to those who influenced Congress to outlaw it, but it was not necessarily unethical to those who saw the regulation of their behavior as a mere political victory on the part of their competitors. Adam Smith's ideology came to mean something like "anything goes."

Under such conditions of ethical neutralism and "power politics," the crime rate is bound to be high. It is easy to break laws derived from a source that one does not respect, and it is easy to manipulate policies in the interests of one's group when few people have much interest in the welfare of all. The biographies of California's robber barons -- Edward Doheny, Charles Crocker, Collis Potter Huntington, Mark Hopkins, Leland Stanford, James C. Flood, William Ralston, John W. Mackay, and Claus Spreckels, to name but a few -- attest to that, as does the story of the riches amassed by the more sophisticated robber barons of the East.[23]

The heritage of the robber barons is still with us. In the business world, especially, the ideology of individualism continues to put the focus on the bottom line and to obscure enduring principles about what is right and wrong in a moral or ethical sense. Regulatory laws and even criminal statutes continue to be viewed as restrictions promoted by one's competitors -- especially socialists -- not as codification of ethical principles or even as attempts to promote behavior "in the public interest," "for the common good," or "for the general welfare."

Thirty years ago, Robert Lane questioned top managers of 25 New England industrial firms about the most appropriate means of reducing the white-collar crime rate. They agreed on numerous measures, including a proposal to decriminalize white-collar offenses. This was to be done by cutting government regulations and controls to the minimum. But the most frequently mentioned suggestion was to "stop the drift to socialism and the restriction of freedom."[24] This proposal is still with us. Modern business leaders' calls for self-regulation and, generally, for more ethical business conduct, are based principally on fear that socialist power will increase if business executives do not become more honest. More specifically, when the business leaders of the 1970s asked individual corporation executives to publish corporation codes of conduct, humanitarian notions about ethics and morals fell well behind the fear of socialism as the raison d'être of the codes.[25]

Business executives who use neutralizing verbalizations

stemming from the idea that one need obey only "good" laws are in bed with robbers -- persons who acquire with individual merit and a gun that which is denied them by the complex orderings and forbiddings stemming from ethical principles.[26] Thorsten Veblen, a turn-of-the-century economist, put the matter this way:

> The ideal pecuniary man is like the ideal delinquent in his unscrupulous conversion of goods and persons to his own ends, and in a callous disregard of the feelings and wishes of others and of the remoter effects of his actions, but he is unlike him in possessing a keeper sense of status and in working more farsightedly to a remoter end.[27]

Although Professor Veblen's "ideal pecuniary man" more closely resembles the nineteenth-century swindlers and robber barons than the vast majority of the executives of contemporary corporations, the figure dramatically calls attention to the fact that a single morality no longer characterizes America, if it ever did. In business circles, "Thou shalt not steal" is persistently neutralized by verbalizations which fuzz up the criminal nature of crimes committed on behalf of corporations. What the law defines as crime is considered as not really crime, and thus as not unethical behavior, if the law is not consistent with the enduring ideology of individualism.

Politics, economics, and ethics have become intertwined. One consequence is this: Illegal economic behavior is considered as not really crime if it perceived as having been been made illegal by political opponents. In socialist countries, and among terrorists, this means that it is not unethical to violate laws perceived to have been enacted just to increase the wealth of only "the ruling class." Among American business executives it too often means that it is not wrong to violate "counterproductive" regulations perceived to have been enacted in the interests of socialism.

## Conclusion

Cultures and subcultures consist of collections of words that are used in prescribed ways. These words make it proper to behave

in a certain manner toward an object designated by the word "cat," and improper to behave in the same manner toward an object designated by the word "cabbage." They also make it "wrong" and "illegal" to behave in certain ways, and "right" and "legal" to behave in others. Significantly, as I have repeatedly noted, words also make it "all right" to behave in some situations in a manner which also is "wrong" and "illegal."

Put another way, when multiple moralities abound, people disobey the law because they have learned that, from many points of view, one can be moral and criminal at the same time. Edwin Sutherland's differential association principle advises us that, in the long run, the incidence of management fraud (and of street crime as well) will decline only as the neutralizing verbalizations supporting these crimes are themselves neutralized.

## Notes

1. Edwin H. Sutherland, White Collar Crime, New York: Dryden, 1949.

2. Erwin O. Smigel, "Public Attitudes Toward Stealing as Related to the Size of the Victim Organization," American Sociological Review, 21:320-327, 1956. Also see Smigel, "Public Attitudes Toward 'Chiseling' with Reference to Unemployment Compensation," American Sociological Review, 18: 59-67, 1953.

3. Marshall B. Clinard, "Criminological Theories of Violation of Wartime Regulations," American Journal of Sociology,11: 258-270, 1946; and Clinard, The Black Market: A Study of White-Collar Crime, New York: Holt, Rinehart, 1952. Also see Frank E. Hartung, "White-Collar Offenses in the Wholesale Meat Industry in Detroit," American Journal of Sociology, 56:25-34, 1950.

4. Quoted by Clinard, The Black Market, op. cit., p. 332.

5. Robert E. Lane, "Why Businessmen Violate the Law," Journal of Criminal Law and Criminology, 44:151-165, 1953.

6. Donald R. Cressey, "Why Do Trusted Persons Commit Fraud? Journal of Accountancy, 92:576-581, November, 1951.

7. Donald R. Cressey, "The Criminal Violation of Financial Trust,"

American Sociological Review, 15:738-743, December, 1950; "Criminological Research and the Definition of Crimes," American Journal of Sociology, 56:546-551, May, 1951; "Application and Verification of the Differential Association Theory," Journal of Criminal Law and Criminology, 43:43-52, May-June, 1952.

8. Both the generalization and the procedures for arriving at it are discussed in detail in Donald R. Cressey, Other People's Money: A Study in the Social Psychology of Embezzlement, Glencoe, Illinois: Free Press, 1953. Reissued by the Wadsworth Publishing Company, Belmont, California, 1971; and by the Patterson Smith Publishing Company, Montclair, New Jersey, 1973.)

9. "Ask Ann Landers," Santa Barbara News Press, January 9, 1963.

10. Robert H. Lowie, An Introduction to Cultural Anthropology, Enlarged Edition, New York: Rinehart, 1940, p. 379.

11. Lowell B. Mason, quoted in Nation's Business, January, 1947, p. 38.

12. Raymond C. Baumhart, "How Ethical are Businessmen? Harvard Business Review, 39:6-16, 156-176, 1961.

13. John Fischer, "India's Insoluble Hunger," Harper's, 190:438-445, April, 1945.

14. Quoted by Dean Rothart, "American Air, Its President, Get Trust Suit Voided," Wall Street Journal, September 14, 1983. Also see William M. Carley, "Antitrust Chief Says CEOS Should Tape All Phone Calls to Each Other," Wall Street Journal, February 25, 1983.

15. Barry M. Straw and Eugene Szajkowski, "The Scarcity-Munificence Component of Organizational Environments and the Commission of Illegal Acts," Administrative Science Quarterly, 20:345-354, 1975.

16. Edward Gross, "Organizational Structure and Organizational Crime," in Gilbert Geis and Ezra Stotland, Editors, White-Collar Crime: Theory and Research, Beverly Hills, California: Sage, 1980, pp. 52-76. At p. 64.

17. Parts of this section are drawn from testimony I presented in

1979 to the Committee on the Judiciary, Subcommittee on Crime, of the United States House of Representatives. (Washington, D.C.: U. S. Government Printing Office, Serial No. 69, July 19, 1979, pp. 108-115, 120-121, 122-124, 126-130,, 132-133, 134-135.)

18. Edwin H. Sutherland, "Crime of Corporations," a 1948 paper published posthumously in Karl Schuessler, Editor, Edwin H. Sutherland on Analyzing Crime, Chicago: University of Chicago Press, 1973, p. 92.

19. Adam Smith, An Inquiry into the Nature and Consequences of the Wealth of Nations, London, 1776. The quote is from the Modern Library edition, Edwin Cannan, Editor, New York, 1937, pp. 548-549.

20. Ibid., p. 207.

21. Ibid., p. 250.

22. See Robert Childres and Stephen J. Spitz, "Status in the Law of Contract," New York University Law Review, 47:1-31, 1972; and Manfred Rehbinder, "Status, Contract, and the Welfare State," Stanford Law Review, 23:941-955, 1971.

23. Stephen Birmingham, California Rich, New York: Simon and Schuster, 1980.

24. Op. cit.

25. Donald R. Cressey and Charles A. Moore, "Managerial Values and Corporate Codes of Ethics," California Management Review, 25:53-77, 1983.

26. See Edward A. Duddy, "The Moral Implications of Business as a Profession," Journal of Business, 15:70-74, 1945; and Harry V. Ball and Lawrence M. Friedman, "The Use of Criminal Sanctions in the Enforcement of Economic Regulation," Stanford Law Review, 17:197-223, 1965.

27. Thorsten Veblen, Theory of the Leisure Class, New York: Macmillan, 1912, p. 237.

Mr. CRESSEY. Let me start by citing three old studies that illustrate how and why people get involved in management fraud. These three studies document how learned attitudes about the nature of business and the nature of government, for that matter, lead inexorably to violations of the law. How people talk to themselves makes a difference. Words make crime.

The first study pertains to the circumstances in which people approve of crime committed against corporations or governments. When Irving Smigel asked people whether they approved or disapproved of stealing from organizations under certain circumstances he found morality to be associated with the size of the victim corporation. For example, half the people in his sample approved of stealing when the victim was a large business or the government but very few of them approved of stealing when the victim is a small business.

The second study focused on violations of the price control and rationing laws during World War II. It is more directly related to management fraud because it deals with crimes committed on behalf of the companies rather than crimes committed against them.

Marshall Clinard, a professor at the University of Wisconsin, found in essence that businessmen violated the price control and rationing laws because they didn't believe in them. Put another way, they had developed verbalizations, words, conversations with others and with themselves, that made the criminal law seem irrelevant. A dislike of Government regulation in general was joined with a dislike of price control and rationing laws in particular. The result was——

Senator BIDEN. Maybe Mr. Carlson can write us a book on how people judge the income tax system—that would be such a vehicle of use.

Mr. CRESSEY. The result of this was language which attacked the very legitimacy of government and therefore made black market operations seem almost patriotic.

The third study was made by Prof. Robert Lane, a political scientist at Yale, who studied crimes among New England shoe manufacturers. His study, like Clinard's showed the important roie that antigovernment language and attitudes play in crimes committed on behalf of corporations.

There were wide variations in the number of shoe firms violating the labor relations law. In Haverhill, MA, for example, 7 percent of the shoe manufacturers violated the labor relations laws. In Auburn, ME, a whopping 44 percent violated the law. Why the difference? Professor Lane was familiar with the same body of social-psychological-criminological theory that I use; it's complicated. It's called differential association, and I won't burden you with that. I've explained it a bit in my paper—because he was familiar with that and was able to see that one of the differences between these two communities, was in what he called attitudes toward the law, government and the morality of illegality.

The shoe manufacturers, he found, who associated with people whose attitudes favored violation were more likely to break the law. He even found differences in reading habits. More generally, he found that in the larger cities—those with a cosmopolitan, di-

versified, social life and greater tolerance for heterodoxy—people accepted and obeyed labor relations laws, more readily than did small town managers and entrepreneurs.

Senator BIDEN. You mean Reader's Digest is the cause of all this?

Mr. CRESSEY. There are three kinds of ideologies that it seems to me are a part of our Nation. They are part of our culture. These three ideologies do lead inexorably, it seems to me, to the kind of management fraud—crimes committed on behalf of the corporations. We so roundly deplore such crimes. But, before I go into that, let me spend a couple of minutes to talk about my own study, which was years and years ago.

I studied why people embezzle. My first book published 50-some-odd years ago was on embezzlement and I went beyond these old studies that I have mentioned to try to figure out how these verbalizations, these attitudes, work to produce embezzlement trust violation in individual cases.

We have a society in which trust is essential. We cannot eliminate management fraud by saying we're not going to trust anybody. Well, I guess we could eliminate, or severely reduce, management fraud by not trusting anybody but we wouldn't do any business either. You have to trust people. The question then is, Why do some people in trust violate the trust and other people don't? And I, when working on embezzlement came up with a theory, a finding that embezzlement—this kind of trust violation involves three phases or steps.

One of them is a feeling that some kind of a personal problem is unsharable. You get into a financial crack that you can't tell people about. Your ordinary sources of income are available. Example: one of my people, a lawyer, retained by a large corporation on a very handsome salary, went secretly into a business which competed with them. He lost everything. He then embezzled, because of fear of falling, and was caught. He told me that in retrospect he could have gone to the president of the corporation from whom he stole the money, and asked him to loan it to him. He would have loaned it to him. But to do so would have required him to admit that he had done this unethical thing—going into competition with him. His financial problem became unsharable.

The second phase or stage involves knowledge of how to solve the problem in secret by violating the trust.

The third one is the most important, and that is the ability to find a formula which describes the active embezzling in words which do not conflict with the image of one's self as a trusted person. In other words, the person searches around in his culture, in his vocabulary, and he finds a verbalization of a Reader's Digest statement that neutralizes his ideas about if I violate the law I'm a bad guy, I'm a crook and so on.

In retrospect, as the lawyer example indicates, they say: well, I was kidding myself; I fooled myself into believing this was true. At the time, however, they really think they are true. For example, the bank embezzler says I'm only going to borrow the money from the bank for a short time, take care of my financial problem and then pay it back. They get caught before they put it back.

Notice that if he says to himself: I'm going to steal the money, he can't do it because he's been reared to believe and to know that stealing is wrong. Borrowing, on the other hand, isn't wrong and so he can get himself out of this crack if he can talk that way to himself—and if he can't talk that way to himself, he won't embezzle.

If you think for a minute that Irving Smigel—the study that I just mentioned—where someone says that they believe that it's not as bad to steal from the Government as it is to steal from a small company—that's a neutralizing verbalization. It is that kind of language which allows people to steal with impunity, it seems to me, from the Government.

Marshall Clinard's discovery that violators of price control and rationing laws don't believe in them.

Lane's discovery that the manufacturers who violate the labor laws are hostile to government.

All three studies call attention to the important role that this neutralizing language plays in criminal behavior.

Now back to the crime—I've been talking about why managers steal from the firm—now let's move back to why they steal on behalf of the company.

There are three ideologies in our society, in our culture, that I think are highly relevant. One of them goes like this—a slogan that we learned on our mother's knee—one of them is: "Honesty is the best policy, but business is business." The second ideology that's very conducive to crime is: it's all right to steal a loaf of bread when you're starving—another thing that we learned on our mother's knee. And the third one I've already alluded to, the idea that government regulation of business is socialistic and counterproductive.

Each of these contributes to the high crime rate committed on behalf of corporations. The first one is obvious: The idea that honesty is the best policy but business is business. The second part of the slogan neutralizes the first. A study published in the Harvard Business Review asked 1,700 corporate executives whether they agreed or disagreed with the following proposition: "The American business executive tends to ignore the great ethical laws as they apply immediately to his work—he is occupied chiefly with gain." Half of them said that's true. And it seems to me that corporation managers do opt for gain—that is, business is business. And in so doing they use methods which are in direct violation of the law, which is summarized in the idea that honesty is the best policy.

I think more significant, however, is the second one—it has the idea of necessity: it's all right to steal a loaf of bread when you're starving. Poverty doesn't cause crime among poor people—most poor people don't violate the law no matter how poor they are. Millions of people, unfortunately, in America go to bed hungry every night. But, when it comes down to it, very few of them steal. Women and girls, for example, are in equal poverty with men and boys, but they have fantastically lower crime rates. Even a good percentage—nobody knows what the percentage is—of the men and boys living in poverty-stricken ghettos of the United States don't commit crime. Thousands of business executives whose companies are going under because the economy has collapsed, don't commit

crime. But, on the other side of the coin, some people in these circumstances do.

The notion that poverty causes crime is absurd if you think of it literally. Poverty doesn't jump up and grab people by the shoulders and push them into crime. But the idea that poverty causes crime is highly conducive to criminality because it informs citizens how they are supposed to behave when they are in poverty. That is, in the case of organized white-collar crime, this idea neutralizes ethical behavior. People steal when they get into a tight spot—you believe that, and so that when you get into a tight spot you steal, you commit crime on behalf of the corporation—some people do.

Something like this must have been going through the mind of the president and chief operating officer of American Airlines when a couple of years ago he, talking with the president of Braniff Airways, suggested a law violation—price fixing—might solve the problem that the two of them are having. He said: "I think it's dumb as hell to sit here and pound each other and neither of us mak[illegible] a dime." The Braniff executive asked: "Do you have any sug[illegible]stions?" The American Airlines president responded: "Yes, I have a suggestion for you. Raise your goddamn fares 20 percent. I'll raise mine the next morning." Now we're in a tight spot so we have some language—which a judge later on said was unprofessional and distasteful—but the judge nevertheless held him—he said this was not an attempt to monopolize airline route, so they were not guilty—but he nevertheless said this language is unprofessional and distasteful, which it is, that it contributes to crime.

Even more relevant is a kind of superior ethic. Bad times come. You're the manager of your corporation and your corporation does good things: it manufactures airplanes or other defense weapons; it makes contributions to thousands of museums, galleries, symphonies, theater groups, and employs all kinds of people. Employees of the corporation contribute much to the local economy—and so bad times come, bad economic times, and bankruptcy or near bankruptcy of the business seems unpatriotic—it's just impossible; it's all right to steal a loaf of bread when you're starving, and so you evoke that language and commit crime that you otherwise wouldn't commit.

And I think similarly—the idea basically that criminal laws are un-American is an ideology which leads inexorably to crime—violation of the law. Again I recall the summaries I made of the three studies. They all found basically the same thing; that is, that we have ideologies which neutralize prohibitions against committing crimes on behalf of organizations.

I testified before a House committee some years ago now, 4 or 5 years ago, and there I made the argument, which I'll not repeat here but which I think is worth calling your attention to, that there's a great similarity between business persons who think this way and terrorists. Terrorists are not deterred by the actions or the laws of a State that they consider illegitimate. Similarly, back in Clinard's day of price control and rationing law violations, the business persons were not deterred by the actions of a State which they considered illegitimate. And we have variations of this ideology existing right now.

If I can just summarize this by saying that in the United States politics and economics and ethics have become intertwined. And a consequence of this is that illegal economic behavior is not considered really crime if the law regulating it is perceived as having been made by one's political opponents: it's a violation of his law not of our law. It's much easier to violate the law if you look at it that way. Too often it seems to me we believe that it is not wrong to violate laws that are considered counterproductive or laws that are said to be in the interest of socialism—some other term indicating that there is disrespect for the governmental process by which behavior is declared to be illegal. And so what I'm saying basically and generally is that cultures and subcultures consist of collections of words that are used in prescribed ways. To take a very simple example, if you behave in one manner, a certain manner toward an object designated by the word "cat," and you behave improperly if you behave in the same manner toward an object designated by the word "cabbage"—it is that simple. And so words make it wrong, illegal, to behave in certain ways. And words also make it all right and legal to behave in others. And so, as I've noted here, words sometimes make it all right to behave in situations in a manner which is also wrong and illegal.

Senator BIDEN. There are number of questions I want to ask but let me make sure I understand the final point and then we'll take a 3-minute break for me to make a quick call to my office and then we'll resume, Professor Cherrington, with you.

I find that people that I run into in politics will say things that astound me; people who are not professional politicians but participate in the process of helping one get elected. They do things in a political campaign that they wouldn't fathom doing at their country club or the union hall or in their own home and I hear the phrase all the time: But that's politics. Is that the essence of what you're referring to in terms of how one views the process, views the context in which the action is taking place?

Mr. CRESSEY. Yes; I think those old slogans or sayings are highly relevant. The notion that "All's fair in love and war, or that's the way politics are" is highly relevant.

Senator BIDEN. In my last campaign very honorable people would say things that were absolutely bold-faced lies and they knew it and you confront them—people you've known socially your whole life, grew up with—you say "Charlie, how can you say that?" They say, "Joe, don't pay attention to that, that's politics, just politics."

I would not draw any sympathy from any constituency because someone called me a horsethief even though they might know it's not true—that's part of the process. It's that mentality, it seems to me, that prevails when I talk to a number—I come from a State that has heard of the corporate structure—the State of Delaware and it's interesting to have discussions with people who would make judgments about what is moral and immoral as distinguished between what is legal and illegal. I had a man call up in the last campaign on a radio talk show and say I'm a chemist, I make $84,000 a year, I must tell you I cheat on my income tax, I'm going to continue to cheat on my income tax—I'm not going to tell you who it is but—this person said I'm not going to identify myself—but one of the things that bothers me most is my next door neigh-

bor is a lawyer, he has all the time in the world to figure out how to take advantage of the tax laws, we make the same amount of money, he's pays about $12,000 less than I do, that's not fair—I'm a bench chemist; I devote my time working on the bench, therefore I think it's not immoral for me to do what I think is wrong for you to do to me in the first place, and that is support a tax structure that benefits him and not me and we make the same amount of money.

It seems to be an attitude that's not unknown and I just wanted to make sure it's the type of thing—I think I followed your testimony.

Let me recess the hearing literally for 3 minutes—until a quarter of, and we'll be right back and then, Professor, if we can begin with you when we come back—we can have a seventh inning stretch here.

[Brief recess.]

Senator BIDEN. This hearing will come back to order.

I know that Professor Wheeler has a flight to catch to get to the west coast and I want to tell him that he's obviously welcome to stay as long as he would like—I fully understand if he has to leave now. And I do have a series of half a dozen or more questions I will mail up to you if you're willing—one of them is: Will you help my son get into Yale? [Laughter.]

That's only a joke—note that they laughed about that—and the other relates to the hearing.

In case you're wondering the reason why the three of you, who are from universities, were invited is because you're the only three schools my son is interested in. [Laughter.]

But he can't play quarterback, Professor, so I'd imagine Brigham Young may not be interested in him.

Mr. CHERRINGTON. There are other positions.

Senator BIDEN. Let me now turn to you, Professor Cherrington. And, to the extent that you are able to stay, Dr. Cressey, I'd like you to, if you could—because I'd like to ask some questions. But, Professor Wheeler, I will send these up to you, these questions, and please feel free to go whenever you need.

Professor, fire away.

## STATEMENT OF DAVID CHERRINGTON

Mr. CHERRINGTON. Thank you. What I've been invited to talk about today is some of the research we've done on fraud and white-collar crime.

I started in 1978–79 with four of my colleagues. Two were in the department of accounting and the other two were psychologists—one at the university and one was the prison psychologist at Utah State Penitentiary.

We had a grant from Peat, Marwick, Mitchell, one of the big eight accounting firms. Their concern was knowing what auditors should be looking for to detect fraud when they go into an organization.

Some accounting firms have been held liable for failing to uncover fraud in their audit engagements. So Peat, Marwick, Mitchell wanted to have someone look at that issue and see if there are sig-

nals that auditors should get as they are auditing the books of an organization that would let us know that there's something wrong—some irregularities that should cause them to look deeper.

The five of us, as a research team, first tried to frame our project and identify what we really wanted to examine. The first question was what level of fraud did we want to study. We wanted to deal with major fraud—white-collar crime—not just small employee theft.

The accountants on our team thought that there was a very clear difference between major fraud and small pilfering by employees.

The psychologist on our team did not agree with that. Their point of view was that white-collar crime and employee theft are activities that differ only by the length of time and the opportunity; that there's no real difference between management fraud at upper management levels versus employee theft, such as taking money from a cash register or under ringing sales. These activities are not different other than the fact that some are smaller because the individuals have fewer digits to play with on the numbers they are using.

Nevertheless, we limited our investigation primarily at the outset to major cases of fraud.

What we tried to do was to get a large sample of the literature that describes some of the major classic fraud cases—cases such as equity funding. Equity Insurance Co. was a major insurance company that for a decade, for a full 10 years, had a massive fraud occurring within it. There were about 120 cases that we reviewed at the beginning, but we narrowed the list to 52 where we felt we had adequate information from newspaper accounts, from journal reports and so forth. And then, with the assistance of some accounting students, we began to read all of the literature we could find describing these different cases. We tried to identify various statements that were made about the frauds and what these frauds were like to see if any of this information would be useful in developing an audit checklist. We wanted to develop an instrument that an auditor could use to say: here's something and here's something and here's something, and these suggest that I've got to look deeper to discover whether something is seriously wrong. We did develop an audit checklist. I'll refer to it in a minute, but first let me describe one of the most interesting conclusions.

Alan Rowe, the prison psychologist on our team, made the statement frequently that the individuals in prison who are white-collar criminals are really quite different than other criminals. For most crimes you can develop a psychological profile of what the individual who committed that crime is like, such as, a rapist or someone who's involved in murder or violent crimes. There is a psychological profile that describes what those people are like, but this is not true of a white-collar criminal.

The guards and prison officials say that white-collar criminals are more like us, they're more like my neighbor, they're more like the run-of-the-mill individual and they don't fit any given profile.

Senator BIDEN. Even among themselves? In other words, it seems like you've defined that they do fit a profile by suggesting they're more like us.

Mr. CHERRINGTON. Actually, what we've found is that their profiles are so diverse but they are more like the average, middle class——

Senator BIDEN. Among white-collar criminals there is no consistent profile?

Mr. CHERRINGTON. No consistent profile that we could identify.

Senator BIDEN. I see.

Mr. CHERRINGTON. We collected data from a number of white-collar criminals within the Utah State Prison and we also wrote to all of the major prisons across the United States and tried to get them to send us data.

We received very little data and so we had to use a very small sample size. We collected data on them in terms of their background and personality profiles from psychological inventories and compared them with a sample of property offenders. We also compared them against a sample of college students.

We found that the white-collar criminals were significantly different on a number of dimensions from other property offenders. When we compared them with college sophomores, we found that there were very few differences. We found that they were very much like the run-of-the-mill average person. When we compared their mean scores with norms of national data, we found that they did not differ significantly. What we concluded is that indeed white-collar criminals are people who are like regular members of society and that you would not characterize them by some of the typical profiles of criminal behavior.

They are people like you and me—like some of the outstanding citizens of society. They vary along a number of dimensions but they do not fit a criminal profile like other types of criminals in prison.

Since you seem to be quite interested in the motives, we looked quite a bit at motives.

Senator BIDEN. By the way, let me make a statement because I may be the only one on the committee that seems interested in motivation. It seems to me if one could determine the motivation, then one theoretically could determine the legislation that would impact upon the motivation. If the motivation were—well at any rate, that's the reason, and I may be mistaken in that assumption—it's something I'm going to ask you all speak to when we get to the question and answer period.

Mr. CHERRINGTON. Could I speak to that right now, briefly, before continuing?

Senator BIDEN. Sure.

Mr. CHERRINGTON. We found four motives that were very prominent. I'm sure there are many others—but these four were the most common. First, we found some individuals who committed their white-collar crime, in their opinion, for the good of society.

I will cite just one example.

I interviewed one man in prison myself. He was the leading businessman in a small community and as the Interstate System was being built around his community, the loss of revenue from tourism was having a very deleterious effect on the economy. Everyone looked to him for leadership. His comment to me was: I am an honest man, I'm as honest as the day is long. I asked him why he

was in prison, and he said: "my back was against the wall; I only did what any rational man would do." He said: "it was the only option I had."

He proceeded to tell me about a credit card scam that he perpetrated where he essentially was able to borrow money and then had to borrow more money to pay off the previous money. After about 11 months it became overwhelming, and I think he wanted to get caught and did.

But his argument was that everyone in that community looked to him for leadership and there was nothing else he could do. He defined the problem in such a way that it was the only alternative and he was doing this for the good of the community. He said: I knew if we could buy time, we'd be OK.

The second motive for white-collar crime that we found was for the company. Price-fixing and a lot of other white-collar crime was perpetrated because employees thought it was necessary to save the company. If the company failed, a lot of people would lose their jobs and there would be other economic problems. The victims here could be stockholders, society, or tax revenues—a lot of different victims. But the beneficiary was the organization. They were doing it not for themselves but for the good of the organization.

A third motive for white-collar crime is careless expediency or casual theft. It was not personal greed at the outset, it was a small casual kind of dishonesty where somehow there was a particular need, such as borrowing money or something else that seemed expedient at the time. But it began to get away from them and, before they knew it, they were involved in a full-blown, major fraud.

As two men who were caught and convicted said to me—they were quoting from a play and I don't know the name of the play, but there's a line in it which goes something like: "There must have been a time, somewhere near the beginning, when we could have said no." They had not intended to commit a fraud at the outset, but after they began it started to mushroom.

Finally, the fourth motive is sheer greed, the desire for money. There we have the case of premeditated fraud where people have planned, schemed, and contrived this fraud over a period of time.

The degree of greed must obviously be placed along continuum here. On one hand you've got computer specialists who simply see this as a challenge, they want to see if they can beat the system.

One individual wanted had no intent to ever commit a fraud but actually defrauded major amounts of money simply to see if he could beat the controls someone else had installed.

In the process of conducting our study we identified many different signals that we thought would indicate the presence of white-collar crime. At first we had some 200 items until we began to pare it down. At the end we had close to 100 different items that we called red flags that should signal to an auditor that something is going wrong. We categorized these into three major categories of red flags.

The first is what we call situational pressures. This refers to pressures that were placed upon an individual which caused that individual to do something wrong. Often this was caused by like gambling debts and expensive living. Professor Wheeler talked

about the "fear of falling," Professor Cressey talked about the lifestyle that the individual maintains—and these are the kinds of situations. People feel that their backs are pressed to the wall, they have no other alternative, they define the situation such that fraud is the only way out.

We found many situational pressures. There were a great number of them. Several of them were associated with supporting a very fast lifestyle—called jet setting. Many of the fraud perpetrators we studied had a jet plane that they used for running around the country like other people run around town. Many of them were trying to support several apartments with mistresses in each one. These kinds of pressures were OK at one time, they could handle them. But after they hit a small economic reverse it was suddenly overwhelming.

Senator BIDEN. Does the pressure of having to meet a quota fall within that category of situational pressure?

Mr. CHERRINGTON. Yes. And we found in some cases there were intense pressures, such as the *Equity Funding* case. Although I know very little about the *E.F. Hutton* case, I suspect that this was also the case there, that those individuals also felt intense pressure to achieve a certain level of earnings or a certain level of growth. In the case of Equity Funding, their top management specified that they were to achieve a certain level of growth over a period of time and the only way they could see that they could respond to that pressure was through selling insurance policies called coinsuring, which ultimately forced them to create bogus insurance policies.

Senator BIDEN. Some have argued that's a subtle form of coercion, allowing top management plausible deniability. That's something we have as a nation to speak to, but I'll get into that later. I've reached no conclusion on that at this point.

Mr. CHERRINGTON. We observed that frequently, and it can be very intense. And the individuals creating the pressure often do not realize that it's being interpreted by lower level people as approval to do anything necessary legal or illegal, to achieve that goal.

Senator BIDEN. Gottcha.

Mr. CHERRINGTON. No. 1 was situational pressures, No. 2 is what we called opportunities. Opportunities included anything that made it more convenient to perpetrate the fraud. It included the knowledge that Professor Cressey referred to a minute ago—having more knowledge about ways to do it would make the opportunity more feasible. The likelihood of getting by with it—getting away with it without being caught—also contributed to the opportunity, as would knowledge that even if you got caught and prosecuted you probably wouldn't go to jail. For example, we were shocked at the statistics associated with computer fraud.

As I recall, the FBI estimates that only 1 percent of computer frauds are ever uncovered. Only 15 percent of those that are uncovered are ever prosecuted. Of those that are prosecuted, only 20 percent receive a prison sentence. If you combine all those probabilities there is one chance in 3,333 of ever going to prison from having committed a computer theft.

The take is even more astounding, while the average theft from something like a street burglary is only a few hundred dollars, the

average theft in computer crime at the time we were looking at it was estimated to be about a half-million dollars.

Senator BIDEN. The average incident.

Mr. CHERRINGTON. The average incident was netting the person who perpetrated it about a half-million dollars.

Senator BIDEN. That's a hell of an opportunity.

Mr. CHERRINGTON. The average white-collar crime, as I recall, was something like $43,000. The average bank robbery was only something like $2,300 or $2,400. So to steal with a pen was far more profitable than with a gun. And if you can do it with a computer, you make big bucks.

So white-collar crime is serious and enormous. We're glad to see a great amount of concern for it.

Anyway, I've talked about two of the three elements of our fraud model: Situational pressures and opportunities.

The third factor was called personal integrity and it referred to the level of integrity or honesty of individuals. We found that many fraud perpetrators seemed to lack person integrity. There are two aspects of the trait of honesty. One aspect is the definition of honesty. Some individuals have not defined what is honest and dishonest. Some people do not have a clear understanding of whether something was illegal or legal. The second aspect is a moral obligation to act honestly. Among those who have defined an action as dishonesty, some of them do not feel a moral quality about it. We found that in order for someone to have high levels of personal integrity, it requires both of those components: A very strong definition of right and wrong and an internal moral commitment to abide by that standard of behavior.

Now, in the paper that I'm going to prepare and send for the record, I will include some illustrations that we've published in our book, "How To Detect and Prevent Business Fraud." It might be well for me to refer to some of the red flags. We put together an audit checklist containing such things——

Senator BIDEN. Excuse me, you said there were four things: Situational pressure, opportunity, personal integrity——

Mr. CHERRINGTON. Three things.

Senator BIDEN. I beg your pardon, I'm sorry, I missed a period.

Mr. CHERRINGTON. Four motives earlier that I referred to.

Senator BIDEN. I'm sorry. Yes, I got your four motives, I want to get the red flag.

Mr. CHERRINGTON. We created an audit checklist and published it in our book. I'd like to give you a flavor of the kinds of questions we asked, questions like: Does the company appear to have dishonest or unethical management? And we find that many auditors can go in and they can begin to sense: Do they seem to be compromising their standards? Is the company dominated by only one or two individuals? Does the company fail to pay attention to details? For example, are the accounting reports very clear and specific and precise? Does the company have unrealistic productivity measurements or expectations? Does the company have poor compensation practices? Is the pay commensurate with the level of responsibility?

We uncovered one case where an individual who was being underpaid and he was embezzling money. When it was discovered, the

manager asked the question: How much is he taking? And when he learned that it was less than $1,500 a year, the manager responded by saying: He's worth at least $2,000 more than we're paying him, just don't say anything about it. We thought this was an interesting approach to employee theft.

Senator BIDEN. Interesting way to compensate.

Mr. CHERRINGTON. It's called job enrichment through fraud.

Nevertheless, we have a number of those kinds of questions that deal with the situational pressures, the opportunities and the level of integrity that's perceived on the part of the individual.

What I'd like to do is move to more of the research that we did—I'm looking specifically at that issue of personal integrity. For us, that was clearly the most important and clearly the most interesting aspect to research.

Our first question was: Can we measure it? And the second question was: What can we do to understand and explain how honesty develops?

We did a fairly lengthy literature review of looking at some of the psychological literature on moral development. One of the most fascinating studies was one that was done way back in the 1920's. Two people by the name of Hartshorne and May did a study where they investigated about 7,000 young children between the ages of 8 and 16, and they put them through a series of tests to see whether the children would behave honestly or dishonestly.

For example, one of the tests was called the planted dime test. They gave the children some puzzle pieces, one of which was a dime, and after they'd put the puzzle together they were supposed to return the pieces. They observed how many of the kids stole the dime.

They had other tests that were called improbable achievement tests. For example, in the bean relay the children were supposed to carry one bean at a time in a spoon and see how many beans could be carried to a jar in a limited period of time. If the number of beans didn't match the number of trips then they knew that someone had taken more beans in the spoon than they were supposed to have done.

Nevertheless, from the various honesty tests they tried to measure the personal honesty of the children. Their conclusion had a very serious impact on the field of psychology for the next 50 years. They concluded that honesty was situationally determined, that honesty was not a personality trait, that the tendency of an individual to behave honestly in one situation would not necessarily carry over to any other situation, that someone who is honest in one of their games may or may not be honest in another game. And it was therefore concluded that honesty is not a personal character trait. I think you have to appreciate the times. 1920 was not that long after the early 1900's when the early research on intelligence found that intelligence was indeed a very stable personality trait. This research showed that someone who did a very good job of solving problems in one situation would also do a very good job of solving problems in many other situations. And so Hartshorne and May had hoped to find that honesty was likewise a general personality trait that could be observed in many different situations, but they failed to do so.

It was not until the mid 1960's when a man by the name of Roger Burton reanalyzed the original data by Hartshorne and May that someone argued that there was a general trait of honesty. But he only found a general trait of honesty for some of the children who participated. He found that some children had never acquired a general and consistent definition of honesty nor had they been consistently rewarded for behaving honestly. And because of a weak definition and inconsistent rewards they had never developed a general trait of honesty. But others of them had developed a trait of honesty and some of them were honest in different situations in spite of the circumstance.

What I think we're beginning to find, contrary to a lot of research in the behavorial science literature, is that indeed there is a general trait of honesty. We directed our research on honesty toward the retail industry.

I would like to review with you two of our studies.

In the first one we designed a questionnaire measuring peoples' attitudes toward honesty situations. The questionnaire contained items that were taken from other preemployment screening tests that are used to predict the honesty of individuals who are applying for work in retail stores. At first we didn't know whether we were actually measuring honesty or not, but after we analyzed the data we concluded that we had a fairly good measure. My brother, Owen, a CPA who teaches accounting at BYU, believed that the accountants and the auditors of the world are the watchdogs of society and would have the highest levels of honesty. And since the American Accounting Association meetings were being held in Hawaii that year and we'd never been to Hawaii, we thought it would be fun to collect some data on the honesty of accountants and go to Hawaii to present this information.

Senator BIDEN. I think I know what's coming. [Laughter.]

Mr. CHERRINGTON. We analyzed four professional groups: lawyers, accountants, business managers—and we had heard that advertising people were the least honest people, so we included a group of advertising people also. We also were going to get groups of students from the same four groups. Unfortunately, we didn't get law students.

Senator BIDEN. I'm not sure I want to hear this conclusion. [Laughter.]

Mr. CHERRINGTON. I think you do.

We also obtained a sample of data from prisoners and also a group of housewives—these are women who did not work outside the home.

Senator BIDEN. You tell me that prisoners are the most honest and we've got a problem. [Laughter.]

Mr. CHERRINGTON. In fact, as you would guess, our prisoners were the lowest. And slightly above the prisoners were the advertising students. Accountants were not the highest. They were just slightly below lawyers and close to the middle. The individuals who clearly had the highest honesty scores were the housewives.

In part of our questionnaire we had some moral dilemmas. Here we presented people with a dilemma and then asked them what they would do. In the interest of time, I won't describe the moral

dilemmas, they simply asked what were the right ways to respond in six situations.

We were not as concerned with what they decided to do as with how they justified their answers. What justifications did they use—what kind of moral reasoning did they use? We found that the least honest people tended to use a style of moral reasoning that is called nonhedonistic-act utilitarianism.

Senator BIDEN. Say that again. Nonhedonistic——

Mr. CHERRINGTON [continuing]. Act utilitarianism. What that says—we used phrases that were taken from the classic literature from——

Senator BIDEN. I honestly wasn't trying to be smart, I just wanted to make sure I understood the phrase.

Mr. CHERRINGTON. Let me use a more popular label here—situational ethics. This is where you decide what's the best thing to do in a given situation based upon the merits of the case—not based upon rule or principle, but on what seems best for all given all the facts of the case.

Senator BIDEN. Listen to your wife is what I decide to do.

Mr. CHERRINGTON. Our data would suggest that's a good way to go about it.

Senator BIDEN. Professor Blakeey said the principle of that study was "mother knows best," but go ahead.

Mr. CHERRINGTON. We found that the individuals who tended to have the highest honesty scores were individuals who had very firmly defined standards—that is, they used a style of reasoning which is either rule utilitarianism or "rule-deontology," which simply means that we don't base it on the consequences of the act but we base it on the act itself. It's a means-versus-end type of issue. We look at the dilemma and we say is this right or is it wrong? And individuals who are able to look at a situation where they've got a general rule that says here's the way I behave given this situation, the ones who have the highest honesty scores. Well, I realize that I can't take the time to explain our styles in——

Senator BIDEN. I'm sorry to take so much of your time, it's just fascinating to me, so keep going, as long as I don't have to worry about the rest of my colleagues.

Mr. CHERRINGTON. Our next study was with retail stores. We went into 22 retail companies—these were department stores that were all of comparable size, different geographical locations.

We collected data from the employees in there—measuring again their personal honesty. We also asked several questions about what we call the climate of honesty inside the store: what were their perceptions about the integrity of top management; were the company policies fair and consistent; did they have a code of ethics and did they follow it; did they have a grievance system; how would whistle-blowing be treated within the organization, and so forth.

It was very difficult for us to get from the stores their inventory shrinkage data, but we were able to obtain some ballpark figures that were adequate.

The shrinkage rates varied rather dramatically. When we talk about inventory shrinkage, we're talking about how much merchandise and money you expect to have versus what you actually have. The national average on inventory shrinkage is about 2 per-

cent. It's attributed to three factors. Paperwork errors only account for about 10 to 20 percent. Shoplifting accounts for about 30 percent. The majority of the loss comes from employee theft—it is the store's own employees who are ripping it off. In some cases, the thefts are small items that are taken or the losses are caused by underringing sales or improper use of the employee discount privilege. But in other cases it's major fraud, where employees are ripping off truck loads of merchandise from the loading dock.

I think perhaps that the most important thing that we learned from that study was that the honesty of the employees and the inventory shrinkage levels within the company were very clearly related to the climate of honesty that was created within the store—not to the external crime; that is, we had some stores that were located in very high crime areas, but the shrinkage in some of those stores was not as clearly related to the external environment as to the climate that was created within the store.

Senator BIDEN. Did you find any correlation between the size of the corporation, the size of the store and the shrinkage of inventory?

Mr. CHERRINGTON. No, but the National Retail Merchants Institute has looked at that issue and size is not a very significant variable in terms of accounting for shrinkage.

Senator BIDEN. OK.

Mr. CHERRINGTON. What clearly seems to be the most important factor in accounting for inventory shrinkage which, for me is largely employee theft, is the type of climate that's created by top management in the organization. We have been talking at great length with managers about the role they play as we've gone around conducting seminars and analyzing organizational climate. We can go into an organization and measure the attitudes of employees and know how well management is doing. Some managers are very shocked. There are some managers who think—"hey, I'm really doing a great job here, I'm honest. Why don't my employees think so? I remember one day I told an executive about one of his employees who said: "I wouldn't touch Mr. So and So with a 10-foot pole, I wouldn't trust him as far as I could throw him."

And he was shocked; he didn't think he had ever done anything dishonest. But nevertheless that perception was influencing the employee's behavior.

I talked, before I came here, to a company president who used to have an inventory shrinkage of close to 2 percent, between 1.5 and 2 percent. He launched a very aggressive effort to change the climate of honesty in his store and his inventory shrinkage now is less than 0.5 percent. Stores don't like to talk about their shrinkage rates, but I asked him for permission to report it. He said it was significantly less than 0.5 percent.

We have seen the climate of honesty in retail stores move in both directions, depending upon the kinds of administrative actions that are taken. The climate can be changed, and we have begun to identify the kinds of things that stores ought to be doing to change it. We have seen stores where it's gone in both directions.

Senator BIDEN. Is there any correlation between the retail product and the inventory shrinkage? Let me be more specific—and I am really relating this as I understand part of the analysis done by

Dr. Cressey—it's not the same thing—but some of the principles you set out, Doctor—and that is: Is there a correlation between the value of the retail product to the community, as viewed by the employee--that is, if they are making pornographic films, do they have a lower esteem for the product they are producing than if they are a retail outlet for——

Mr. CHERRINGTON. Critical medical instruments.

Senator BIDEN [continuing]. Critical medical instruments.

Mr. CHERRINGTON. I don't have any data, and all I could do is guess. But I would hazard the guess that individuals behave in their moral behavior consistent with their moral values. And for me it's basically inconsistent for someone to feel really strong and committed to what they are doing if they know that what they are doing is for the detriment, the damage, of society.

So I don't know. I can look at some——

Senator BIDEN. The reason I ask: you know, growing up, you hear people who would do things, people who were otherwise totally honest—one fellow I know, I worked on a construction crew with—he worked for the DuPont Co.—I asked where did you get these gloves, these work gloves are great gloves. And he said, oh, hell, I take them from the company, they've got so many, they rip everybody off anyway. I mean, it's this notion that he didn't think he was doing anything wrong taking these gloves that would cost $12, $14, in a hardware store—he literally had six or seven pair of them; he'd use them twice, say he lost them, and take them out. Or the General Motors Corp. in Delaware where, you know, people walk out with tools, the notion being, the explanations you hear when you are growing up—somebody saying, well, what the hell, they rip the public off anyway, it's a piece of junk they are producing—as opposed to not hearing that kind of assertion—I take it back: I said the first instance was DuPont, actually it was the Electric Hose & Rubber Company—as opposed to people who work for the DuPont Company where there seems to be an ethic imposed that is so dominant in my community, that you don't hear people saying that kind of thing; they don't walk out of the DuPont Experimental Station—they probably do, I don't know that they do—but my impression is they don't walk out of the DuPont Experimental Station with lab equipment and say, you know—because the ethic is somehow they are saving humanity there; I mean, you know, you talk to people in the community and you'd think that if you don't work for DuPont, you are somehow immoral; I mean, you know, they are doing such a phenomenal thing for society. I mean, seriously, it seems to be an ingrained attitude.

And I wonder whether that kind of corporate attitude about what they, the corporation, are doing or producing impacts upon attitudes of employees. Maybe I'm too far afield here.

Do you understand what I'm driving at? Since you studied only retail outlets——

Mr. CHERRINGTON. We didn't only study retail, but that's the only one I am taking the time to talk about.

Senator BIDEN. Maybe you can speak generally to that question. And I apologize to Mr. Carlson—I promise you will get equal time on all of this, but I don't want to let these go by without raising them.

Mr. CHERRINGTON. I perhaps ought to say that some of the conclusions I am going to report to you now come from another survey I did. My interest is in values and honesty is only one of them. I spend a lot of time looking at the work ethic—the moral feeling that people have about pride and craftsmanship in their work, and so forth.

Senator BIDEN. Well, maybe I should withhold my comments, then.

Mr. CHERRINGTON. And we find that commitment, loyalty, integrity, and other moral feelings that people have, particularly as it relates to the company, are determined mostly by their interaction with their immediate supervisor and the climate of honesty, and the commitment to excellence that is created there.

After you get more than 200 or 300 people in an organization the organization is too big for individuals to really relate with. There are some managers that do a fairly good job creating what we call a "corporate culture," and organizational theorists are doing a lot of studies now analyzing corporate culture and the myths and stories and the ceremonies that comprise the organization's culture.

But we find that instead of dealing with forces that create values at the macrolevel, we deal with the microlevel, with the work group, and assess the influence that is created by a supervisor.

We find that a moral belief in honesty often comes down from the top. And, you know, this is something in our society that concerns me a great deal, because we have seen organizations go both ways and honesty in our society can also go in either direction. In the case of Equity Funding we see where, over a decade, a major fraud started as a small dishonest act, but it began to grow, it began to mushroom.

One of the classic cases of dishonesty killing a corporation is the story of American Woolen. Fifty years ago American Woolen used to be one of the major top 100 American companies. By every standard American Woolen still should be around as a major corporation: we still have sheep, they still produce wool, and we still wear clothing. But American Woolen developed a climate of dishonesty within it—almost everyone was on the take, almost everyone was participating in embezzlement, and condoning it in others until finally the organization died.

Senator BIDEN. It may be a naive view, based upon my own upbringing and background, but I believe that of Government work, too: I think we set a climate—I think from Presidents down through elected public officials, that if they seem to condone actions which are viewed by others previously to that to be immoral, that it sets a climate, a tone, for a nation in terms of moral standards and values.

But we are not here, I guess, to study that. I just want to lay out what is probably already apparent, my prejudice in this area. And I tend to agree with your assessment of how much management and the perception of the honesty or dishonesty of management, at whatever level—the closer in, the bigger the corporation, maybe the more important—impacts upon attitudes, ethical values, and actions of individuals within corporations. I admit that prejudice before I come in.

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Mr. CHERRINGTON. Well, I share that feeling, and I feel that we have good evidence that it is true. As a society, if we don't have strong leadership at the top, I think that we suffer. And I believe that there is no such thing as small and trivial theft; small theft is never trivial and insignificant. Small theft begins to weaken the moral fiber and the commitment and the moral integrity within an organization, and it has a cumulative effect over time.

It takes a very strong leadership at the organizational level—in a retail store, for example—to begin to change a climate of dishonesty. Earlier I heard you ask whether we should be responding to issues in terms of whether they were moral versus immoral as opposed to simply legal versus illegal.

For me that is a very critical issue, because I think that as a society we have got to focus on issues that create a sense of moral integrity that are going to have a far-reaching impact.

And I guess in this regard, as I look at some of our data and put it in perspective with a lot of other psychological data, we see that moral development is not something that occurs all at once, it occurs in stages, as a sequential process of development. The first stage is called compliance, where people are willing to comply with the rules and the laws and follow what they do just for the sake of avoiding punishment, or to be rewarded. I think a lot of people are content with the level of reasoning.

But the problem with relying on this level of moral reasoning is that we don't have the capacity to legislate every kind of activity.

Senator BIDEN. We really don't.

Mr. CHERRINGTON. So what we need to do is have people feel an internal sense of obligation to comply with standards of right and wrong, many of which may not be formally legislated. People need to acquire a basic sense of moral obligation to choose what is for the good of society and for others.

So, we see compliance as the first level of moral reasoning, and second is what we call identification—where you begin to identify with the standards of others and begin to do the right thing because it pleases others who are important to you.

Senator BIDEN. I don't disagree with that. Let me make one other point—and I appreciate you allowing this to be more of a dialog than a formal question-and-answer, statement-and-response period.

One of the things that disturbs me most about the perception that major corporate leaders in America are immune from the law is not that we are going to impact upon the climate and attitude and ethical values of the person working on the assembly line, or the accountant with the computer, or the financial officer with the $100,000 loan authority, by legislating something, but that if we do not deal with what the average housewife, I believe, believes is an unethical conduct, that we then are moving into the situational ethics as a government where we are condoning—and letting the word go forth that we, too, believe and understand that it's all right, when you believe the law doesn't make sense or impinges upon society, to make the judgment on your own. And then when the corporate official, whether it's a major defense contractor or a Government official within the bureaucracy, or whomever, at a high level, a management level, makes the judgment that then

goes unattended to, either because the mechanism does not exist in the law to prosecute, or, once prosecuted, is not dealt with in a stern way—it seems to me that that passes on a message, not that you can get away with it, therefore do it, but it implicitly says we didn't think it was all that wrong to begin with; we don't think it's bad to do those things, whatever they may be. That in turn, it seems to me, impacts upon the standards that individuals at a much lower level in a corporation—and I include Government in that, because it's a giant corporation, in a sense—that they say, well, why me; there's nothing wrong with doing this, this is an all right thing to do; if they go out there and they can rip off the Government for $1 million on this contract—what difference does it make whether I take these tools that are valued at $250?

Or am I just barking up the wrong tree? Do you understand the point I'm trying to make?

Mr. CHERRINGTON. Yes, and I agree with you. To the extent that we begin to justify and excuse any form of dishonesty and or create an impression that everyone is doing it, I think we destroy the climate of honesty. We see the same thing in organizations. And when we start to see that perception: everyone's doing it—and, as Professor Cressey was saying, we generate the verbalizations——

Senator BIDEN. Or even beyond that. What we seem to be saying, as translated to me by—and I use the sort of all-encompassing phrase of the housewives of America: Senator, you not only have said in this case or that case—you, the Government—that you seem to be condoning, but you are saying something else; you are saying, well, we can't think of any way to legislate saying that's wrong.

Yet we all sit here and say it's wrong to do. But yet we don't sit here because we can't figure out a way to do it, to legislate something to say it's wrong to check-kite on a grand scale, to play with deposits and the timing of deposits in order to maximize your leverage and your profit. We sit here and the Justice Department says to us, look, Senator, we couldn't get them because the mechanism wasn't there to do it, the legal framework wasn't available to us. And then we say, you know, it's so complicated, it's so difficult, we—some of my colleagues have argued: let's not get into this, Joe, we don't know the way out.

My worry is unless we figure out a way to respond to what I believe is a genuine gut reaction by people who I believe to be—maybe again naive—I believe the American people are basically moral and decent—I'm not being condescending, I really mean that. I think they are like the housewives you tested, the vast majority of them, the most honest people out there, and their instinct says: that's wrong. And their Government says, yeah—they either say, yeah, it's wrong, but we don't know how to deal with it, or, if we deal with it, we may trample on something to make it worse. Or, on the other hand, we say it's not wrong.

Whatever we do—either of those two things—it seems to me to create a climate for what we are now seeing develop.

I am anxious to hear from Mr. Carlson, who has been incredibly patient here—but my guess is that income tax evasion, to the degree we can measure it, is probably significantly up over the last 20 years. Maybe I'm wrong—I don't know; I'm anxious to hear

what you have to say. I think it permeates everything we do, and it goes to really a moral climate that I think is corrosive.

And that's the real reason why—although some people thought that it's not a waste of time, but maybe not the most profitable use of time, to have academics come in and talk about this—I think unless we answer that threshold question: Is it worth the effort to try to impact upon these perceptions, because they impact on the climate—if you can't answer that question affirmatively, then I would argue there are many other things we should be spending our time on. We should be out there addressing a number of problems that we can get our hands on, we can wrap our arms around, we can identify—and where we can legislate. We can legislate drug trafficking—can't legislate why people use it—but we can deal with that kind of thing. We can legislate specific types of fraud and crime—we can get into dealing with it.

But if we can't answer the question whether or not the perception that seems to prevail, based on the polling data and the rest, among the public today—and that is that if you are big, if you are powerful, and if you make it complicated enough, you are likely to escape with—whether that's right or wrong—you are likely to escape without having to pay a penalty; ergo, my Government, which I hope to be decent and honest, either thinks it's honest behavior or it's behavior that is beyond its control.

In either case, it impacts upon my attitude about what I think about my Government and what is viewed as moral, rational conduct for me to engage in.

I'm doing more talking than I should—but that's what I am trying to grapple with here. And if I sense—if I am correct in sensing what all three of you have said thus far, is that there is, in some way at least, a correlation between attitudes and actions—how we treat what we say, the words, whether we say that's right or wrong, whether we say we can or should deal with it. My worry is that we are going to tend to overreach and we are going to do things that may be worse than if we didn't do anything at all.

But that's something I think we've got to take the chance in wandering into rather than sit back and say, yes, it is unsavory, it is tough that we identify and General Dynamics pleads guilty to the following amount of fraud against the Government—but we are going to debar them, and then we find out that they are only ones that can make the *Trident* submarine anyway, so we can't debar them really—we are going to penalize them for 2 weeks or 2 months. And in fact that doesn't penalize them at all, because there is no competition. Therefore, what you do is you say at the end of 2 months: you've been bad boys, but now you go back, since you are the only one that can build a *Trident* for us anyway, go ahead and do it—and you walk away and it's like, huh, what in the hell happened? Nothing.

End of my comment. That is what I am groping for here, and you are—I guess what I am trying to say to you is: if I am reading the wrong message, because I am not a professional sociologist, psychologist, or criminologist—if I have misunderstood what you are saying, now is the time to correct me, because I sense, from what the three of you have been saying, that although this is dangerous territory to tread into, it is something that we should tread into,

and hope, with some guidance from you and others, to not trample on too many things in the process.

Am I making any sense?

Mr. CHERRINGTON. We wish you well.

Senator BIDEN. I'm not kidding you: I sincerely appreciate your testimony thus far.

Let me ask, since I am going to go into some of these things and give you an opportunity to respond to specific questions—let me ask, because, speaking of trespassing and trampling, I have trespassed on the good graces of Mr. Carlson so long—I will let you make your statement uninterrupted, Mr. Carlson—and I promise I won't keep you all for more than another half hour. As you can probably sense by now, I could keep you here for hours and hours, because I find your testimony fascinating and helpful.

But let me not keep you. I promise you will be out of here by 4:30, if you can hang on till then—it's a quarter to 4.

[Prepared statement follows:]

# DETECTING AND PREVENTING WHITE COLLAR CRIME

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The purpose of this report is to summarize what we have learned over the past eight years regarding the causes of fraud and white collar crime and the development of honesty. As an interdisciplinary research team, we began our study in 1978 with a grant from Peat, Marwick, Mitchell and company.[1] Our first study was an analysis of the characteristics associated with white collar crime and from this analysis we produced an audit checklist that was designed to help auditors detect the likelihood of fraud and embezzlement. Our later research focused specifically on the factors that contribute to the development of honesty and integrity, particularly in retail stores. As a result of our research, we have identified several recommendations to reduce white collar crime and to create a climate of honesty.

Much of our research has focused on the responsibility of the accounting profession for detecting and deterring white collar crime. Indeed, fraud can be noticeably reduced if external audits and internal accounting procedures are carefully designed. But the magnitude of white collar crime is so enormous and its causes so complex that auditors and internal accountants alone cannot solve the problem. Organizational leaders, law enforcement officials, and legislators can also reduce fraud by the design and administration of organizational policies, law enforcement procedures, and legal requirements. The purpose of this article is to describe the changes that can be made to deter fraud and the reasons why everyone should share this responsibility.

## WHITE COLLAR CRIME

### Defining White Collar Crime

In reviewing the literature on fraud, the first problem we faced was finding an adequate definition of white collar crime. The label white collar crime has been used to describe (a) crimes committed by anyone from the upper social-economic class, (b)

crimes committed by business executives to further the financial interests of their company, or (c) crimes committed against a company by one of its executives. This definition seems to suggest that the fraud perpetrated by white collar employees is significantly different in nature and motive than fraud perpetrated by lower-level blue collar employees. After some debate, we concluded that the difference between white collar crime and other forms of fraud was quite artificial and distinguishing between them was very arbitrary. Ultimately we dismissed the issue by simply focusing on large frauds, generally in excess of $50,000, regardless of who committed them.

Defining white collar crime in terms of the perpetrator's position in an organization did not produce a very worthwhile or useful definition. The only real difference between a financial officer who embezzles $5 million and a shipping clerk who embezzles $5,000 is that the finance officer is working with numbers that have more digits than the clerk. The major difference between small employee pilfering versus sizable white collar fraud is essentially only a difference in time and opportunity.

The Motives Underlying White Collar Crime

Distinguishing between white collar crime and other forms of fraud in terms of the dollar amounts or based on the perpetrator's job was not particularly useful. Instead we found that it was useful to identify and explore the motives underlying the fraud. As we examined the various cases of fraud, we observed a variety of motives explaining its occurrence. Four significantly different motives include the following:

1. To benefit the community. Although it was not observed very frequently, some white collar criminals argued that the reason for their crime was to protect the community or a special group within it. For example, one executive perpetrated a credit card fraud to help a small group of businesses in a rural community which were suffering a serious economic crisis. In another case, the trustee of a pension fund embezzled pension funds to support a local youth home.

2. For the company. Some cases of fraud were motivated by a desire to benefit the company. These cases included material misrepresentations of the financial statements to defraud the consuming public. In these situations those who perpetrated the fraud did not benefit directly from their dishonest actions. Instead their actions were intended to protect or profit the company.

3. Casual crime. In some cases, fraud was a by-product of actions that were motivated by another desire. These individuals did not originally intend to commit a fraud, but after they had started, they didn't want to or didn't know how to inconspicuously correct the wrong. Some computer programmers had no intention at the beginning of embezzling funds. They only wanted to test the internal program. For them it was an intellectual challenge to see if they were smarter than the programmers who created the control system. Other individuals benefitted from paper work errors or improper fund transfers and simply chose to not correct them. Eventually, however, they were required to forge documents or misrepresent reports to prevent the errors from being discovered.

4. Premeditated fraud. The majority of fraud was a premeditated and planned attempt to secure illegal funds. Here the motive was greed and the desire for more money. This motive led to a wide variety of illegal behaviors including embezzlement and defalcations perpetrated by employees against their employers and other improper actions such as bribes, kickbacks, violations of regulatory agency rules, or failing to follow the proper internal control system procedures.

Characteristics of White Collar Criminals

According to prison officials there is a general perception that white collar criminals are different than other criminals. Although this perception is widely accepted, we were unable to find any published evidence supporting it. However, it was the impression of some members of our research team that white collar offenders were more like normal citizens than like other prisoners. Allan Roe, a member of our research team and psychologist at the Utah State Prison, noted that most white

collar criminals incarcerated in the Utah State Prison were so completely different from other criminals that they associated more with the prison officers than with other criminals. Consequently we decided to collect and analyze our own data comparing the demographic data and results of a psychological inventory for a sample of white collar criminals and other property offenders.[2]

White collar criminals were selected who committed crimes against their employers which usually involved embezzlement of more than $5,000. Property offenders were those involved in burglary, theft, and robbery. The sample included 667 property offenders and 42 white collar criminals from a national prison sample and the Utah State Prison. In analyzing these data we found the following:

1. White collar criminals were considerably older than other property offenders. This makes sense since they must have worked into a position of trust where there was an opportunity to commit fraud.

2. A higher proportion of white collar criminals were female.

3. None of the white collar criminals were tattooed whereas 61 percent of the other property offenders were tattooed.

4. The proportion of white collar criminals who were divorced was much lower than the proportion of other property offenders who were divorced. It appeared that most white collar criminals lead more happy family lives.

5. White collar criminals had much more education than other property offenders.

6. White collar criminals were much less likely to have used drugs than other property offenders.

7. On average, a much higher proportion of white collar offenders were members of some religion and more actively involved in it than were the other property offenders.

8. The white collar offenders had far fewer entries on their "rap" sheets (arrest and conviction records) than did other property offenders.

9. The white collar offenders had much higher IQs than did other property offenders.

10. The results of the psychological tests showed that white collar criminals scored much higher than other property offenders on measures of self-esteem, self-sufficiency, achievement motivation, social conformity, self-control, kindness, empathy, optimism, and family harmony.

We also compared the personality profile test scores of our white collar criminals with the scores of a sample of college students. It was found that there were only six personality scales (out of 15) that produced significant differences between the incarcerated white collar criminal and the college student. On three of the six scales, the white collar criminal scored more pathologically than the students, while the students scored worse on the other three. Overall, the white collar criminals' personality scores were much more similar to those of the students than to those of other property offenders.

In examining these results, we tentatively concluded that white collar criminals are much more like the average person than they are like other property offenders. We admit that this sample is small and that the results may be biased, but we believe that these results help explain the popular view in the literature that many white collar criminals are really average people borrowing from the company and who somehow reached a point where they felt a higher reward in not repaying what they had taken than in repaying it.

Fraud Model

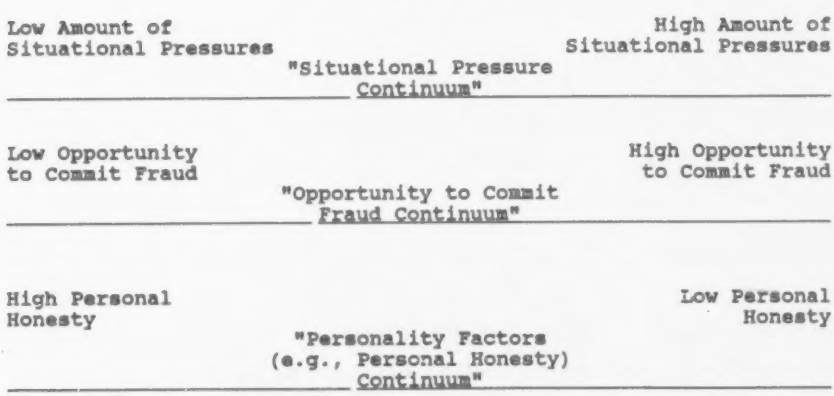
The focus of our early study was to develop an audit checklist to alert managers and auditors to the probable existence of fraud. An extensive review was made by our research team of the relevant literature in business, sociology, psychology, criminology, and moral development, including a review of over 1500 journal references, contacts with numerous organizations concerned with fraud, and interviews with fraud perpetrators and victims. This review generated a red-flag list of factors that appeared to be related to fraud. Although our

initial review included over 100 cases of fraud, we ultimately analyzed 72 of these cases in depth to evaluate how frequently the factors in the red-flag list appeared as significant predictors of fraud.[3]

The extensive review of the literature produced a lengthy list of factors associated with fraud. Some factors appeared to be part of the situation that caused the fraud to occur, for example, unfavorable earnings, a profit squeeze, personal gambling debts, heavy investments, and so on. Other factors appeared to result from the fraud, such as attempts to hide an embezzlement, the use of several different auditing firms, failing to give auditors needed information, and numerous year-end transfers and adjusting entries.

While the initial list was long and unwieldy, an examination of the various factors suggested three major factors: situational pressures, opportunities to commit fraud, and personal integrity. We concluded that the decision to commit fraud resulted primarily from an interaction of these three factors, as shown in Figure 1.

Figure 1


Low Amount of Situational Pressures
High Amount of Situational Pressures
"Situational Pressure Continuum"
Low Opportunity to Commit Fraud
High Opportunity to Commit Fraud
"Opportunity to Commit Fraud Continuum"
High Personal Honesty
Low Personal Honesty
"Personality Factors (e.g., Personal Honesty) Continuum"

Situational Pressures

Situational pressures referred to the immediate pressures an individual experienced within the environment. The most overwhelming pressures were usually high personal debts or financial losses. Low incomes and indebtedness contributed to financial pressures, but gambling, stock market speculation, and

expensive habits or tastes were generally the most significant causes of intense financial pressures. Situational pressures could also be generated by strong peer group influences and even by official directives from leaders in the company to achieve unrealistic performance objectives at any cost. Occasionally, situational pressures encourage individuals to commit fraud for the company rather than against the company, such as the threat of losing a business license, delisting from a stock exchange, or a cash shortage.

Opportunities

Examples of individuals creating opportunities to commit fraud include increasing personal knowledge of the company's operations, advancing to a position of trust, and becoming the only person who knows a particular procedure (such as modifying the computer programs). A company can increase opportunities for employees to commit fraud by allowing related party transactions, having a complex business structure, using several different auditing or legal firms, or having a weak internal control system. Anything contributing to the concealability of a fraud also increases employee opportunities.

Personal Integrity

Personal integrity refers to each person's personal code of ethics. While this factor appears to be a straightforward determination of a person's honesty, the issue is, in fact, more complex. An extensive study of 8,000 youths from 1924 to 1930 concluded that honesty was not a general personal trait like intelligence, sociability, and achievement and that honest behavior in one situation was not necessarily related to behavior in a different situation.[4] For example, students who cheated in one activity did not necessarily cheat in other activities. The study concluded that honesty or dishonesty was determined by the situation (the importance of succeeding, the chances of being caught) rather than from a general personality trait.

Later research has suggested that honesty is situationally determined for some people but a developed personality trait for others.[5] The difference between situational and generalized

honesty appears to be determined by general definitions of honesty and consistent reinforcement for honest behavior. An individual must acquire a general definition of honest and dishonest behavior and know which principles to use in classifying future situations to develop a general trait of honesty. Further, individuals need to be consistently reinforced for honest behavior before they will internalize a standard of honesty.

Interaction of Three Factors

The decision to commit a fraud is determined by the interaction of all three forces. A useful way to visualize the interaction is to picture a balance scale with three connecting bars at the top, each having a weight that can move independently in either direction. The sizes of the weights and their locations along the bars thus determine which side of the scale is heaviest.

This model is an additive model in which the balance tips in favor of committing fraud when any combination of the three weights is sufficient. Some have suggested that the model should be reconstructed as an interactive model with minimum levels of each factor before the other factors can tip the scale toward a fraudulent act. Specifically, some have claimed that personal integrity must be compromised to some degree before opportunities and pressures can entice an individual to be dishonest. Perhaps the figure should be treated as an interactive model, but our interviews with white collar criminals seemed to imply an additive model. Some appeared to have exceptionally high personal integrity, citing situational pressures that would have compelled even the most honest man to do the same.

This model highlights an important insight: theft and fraud can be perpetrated by otherwise honest individuals if they are placed in a bad environment. Because of intense situational pressures or convenient opportunities, some individuals perform dishonest acts even though they consider themselves honest individuals. This situation is illustrated by the comments of a prominent business and civic leader serving a five-year prison term for fraud.

> All of the other businessmen in town looked to me for leadership and security, and when our community faced a serious economic crisis, I perpetrated a credit card scam to save my own business and several others. But I don't consider myself a dishonest person; I have as much integrity as the next guy. I only did what I had to do. My back was against the wall and I had no other choice. If you could only appreciate my situation you would understand why I did what I did.

Perceiving himself as an honest person with as much integrity as anyone else is a common perception among many white-collar criminals.

We frequently assume that individuals who steal make a conscious decision to behave dishonestly. However, most people who steal are not making a conscious decision between honesty versus dishonesty. Instead they identify a variety of alternative methods of obtaining what they want, and simply choose the best one. Theft just happened to be one of the easiest alternatives.

An interesting philosophical question is whether a person's level of personal honesty can ever be so high that he or she is beyond the point of being overcome by situational pressures and convenient opportunities to commit fraud. On the other hand, a very practical question is whether the opportunities to commit fraud can every be so tightly controlled that fraud will be deterred regardless of the level of personal honesty and situational pressure.

Red Flags

The list of red flags we developed for detecting fraud was designed to identify (a) situations where people or groups of people are placed in positions where the pressures to commit fraud become too great for them to handle, (b) situations where people have easy opportunities to commit fraud, and (c) personality factors indicating that people may behave dishonestly. The following factors were mentioned in the literature:[6]

**SITUATIONAL PRESSURE RED FLAGS**

I. Personal

A. Financial Pressures
1. High personal debts
2. Severe illnesses in family
3. Inadequate income and/or living beyond means
4. Extensive stock market speculation that creates indebtedness
5. Loan shark involvement
6. Excessive gambling
7. Heavy expenses incurred from involvements with other women/men
8. Undue family, peer, company, or community expectations
9. Excessive use of alcohol or drugs which cause indebtedness

B. Revenge motives
1. Perceived inequities (e.g., being underpaid, poor job assignment)
2. Resentment of superiors
3. Frustration, usually with the job

II. Company

A. Financial Pressures
1. Unfavorable economic conditions within that industry
2. Heavy investments or losses
3. Lack of sufficient working capital
4. Success of the company depends on one or two products, customers, or transactions
5. Excess capacity
6. Severe obsolescence
7. Extremely high debt
8. Extremely rapid expansion through new business or product lines
9. Tight credit, high interest rates, and reduced ability to acquire credit
10. Pressure to finance expansion through current earnings rather than through debt or equity
11. Profit squeeze (costs and expenses rising higher and faster than sales and revenues)
12. Difficulty in collecting receivables
13. Unusually heavy competition (including low-priced imports)
14. Existing loan agreements with little flexibility and tough restrictions
15. Progressive deterioration in quality of earnings
16. Significant tax adjustments by the IRS
17. Long-term financial losses
18. Unusually high profits with a cash shortage
19. Urgent need for favorable earnings to support high price of stock, meet earnings forecast, etc.
20. Need to gloss over a temporary bad situation and maintain management position and prestige
21. Significant litigation, especially between stockholders and management
22. Unmarketable collateral
23. Significant reduction in sales backlog indicating future sales decline
24. Long business cycle
25. Existence of revocable and possibly imperiled licenses necessary for the continuation of business
26. Suspension or delisting from a stock exchange
27. Fear of a merger

**OPPORTUNITY RED FLAGS**

I. Personal

A. Personally Developed Opportunities
1. Extinsive familiarity with operations (including cover-up capabilities)
2. Occupies a position of trust
3. Close association with cohorts, suppliers, and other key people

B. Firm Environments Which Foster and/or Create Opportunities
1. A firm which does not inform employees about rules and disciplines of fraud perpetrators
2. A firm in which there is a rapid turnover of key employees who quit or were fired
3. A firm in which there are no annual vacations of executives
4. A firm in which there are not rotations or transfers of key employees
5. A firm which does not use adequate personnel screening policies when hiring new employees to fill positions of trust
6. A firm in which there is an absence of explicit and uniform personnel policies
7. A firm which does not maintain accurate personnel records of dishonest acts or disciplinary actions for such things as alcoholism and/or drug use
8. A firm which doesn't have a documented code of ethics
9. A firm which does not require executive disclosures and examinations
10. A firm which has weak leadership
11. A firm where management is perceived as dishonest
12. A firm which has a dominant top management (one or two individuals)
13. A firm which is always operating on a crisis basis
14. A firm which pays no attention to details
15. A firm in which there is too much trust in key employees
16. A firm in which there are relatively few interpersonal relationships
17. A firm which does not have viable dissatisfaction and grievance outlets
18. A firm which does not evaluate performance
19. A firm which does not have operational productivity measurements and evaluations

II. Company

A. Nature of Firm
1. A firm which has related party transactions
2. A firm which has a very complex business structure
3. A firm which does not have an effective internal auditing staff
4. An extremely large and decentralized firm
5. A highly computerized firm
6. A firm which has inexperienced people in key positions

B. Relationship with Outside Parties
1. A firm which uses several different auditing firms
2. A firm which has a reluctance to give auditors needed data
3. A firm which changes auditors often
4. A firm which hires an auditor that lacks expertise
5. A firm which persistently brings unexpected information to the auditors' attention
6. A firm which changes legal counsel often
7. A firm which has a reluctance to give accounting information to their legal counsel
8. A firm which has several different legal counsels
9. A firm which uses several different legal counsels
10. A firm which has continuous problems with various regulatory agencies

C. Accounting Practices
   1. A firm which has large year-end and unusual transactions
   2. A firm in which there are many adjusting entries required at the time of the audit
   3. A firm which supplies information to auditors at the last minute
   4. A firm which has a poor internal control system or does not enforce internal control procedures
   5. A firm which has unduly liberal accounting records
   6. A firm which has poor accounting records
   7. A firm which has inadequate staffing in the accounting department

**PERSONALITY RED FLAGS**

I. Personal Traits

   A. A person lacking in the development of personal moral honesty
   B. A person without a well-defined code of personal ethics
   C. A person who is a "wheeler-dealer," i.e., someone who enjoys feelings of power, influence, social status, and excitement associated with rapid financial transactions involving large sums of money
   D. A person who is neurotic, manic-depressive, or emotionally unstable
   E. A person who is arrogant or egocentric
   F. A person with a psychopathic personality
   G. A person with threatened self-esteem
   H. A person who is intrigued by the personal challenge of subverting a system of controls

II. Personal Demographics

   A. A person with a criminal history
   B. A person who has questionable associates
   C. A person with poor references

HONESTY AND INTEGRITY

The Climate of Honesty

In the summer of 1980, we studied employee theft in 22 department stores which were part of three major retail corporations.[7] The purposes of this study were 1) to examine the relationship between employee's honesty attitudes and actual theft, and 2) to identify conditions which contribute to a climate of honesty in retail stores.[8] Employees in these stores were asked to complete a questionnaire which measured their attitudes toward honesty and other background characteristics.

The inventory shortage levels in these three corporations were significantly different and the results indicated that the levels of shortages were associated with the honesty of the

employees and the climate of honesty in each store, as shown in Figure 2. The company with the lowest level of inventory shortages had employees with the highest average honesty scores while the lowest honesty scores were reported by the employees of the company with the highest shortages. When we examined the FBI crime statistics for each of the three areas we found that the shortage levels were not necessarily related to the amount of external crime within the community. Instead, the shortage levels were highly correlated with variables inside the stores such as the honesty attitudes of the employees and other organizational variables which we referred to as climate variables.

Comparisons of Three Retail Companies

**Figure 2**

| Variable | Company A | Company B | Company C |
|---|---|---|---|
| Honesty Scores | High | Medium | Low |
| Inventory Shrinkage | Low | Medium | High |
| Crime Rates | Medium | Low | High |
| Climate of Honesty | High | Medium | Low |

A climate of honesty refers to the general expectations in the minds of employees about the importance of honest behavior. Although employees do not have identical attitudes, many of their perceptions about important organizational conditions tend to be remarkably similar. Most organizations have a mediocre climate of honesty, characterized by a set of beliefs which holds that (a) honesty is important even though it is not discussed openly or frequently, (b) dishonest employees will be fired if they are caught, but (c) they will not be prosecuted unless the thefts are large, and (d) the employees already know what is right and wrong without having to be told. A few organizations have a much more favorable climate of honesty characterized by high levels of trust, a carefully defined and openly discussed code of ethics, and a general consensus that employees throughout the organization are committed to moral integrity. At the opposite

and are companies with a climate of dishonesty where the employees have a general perception that dishonesty is rampant throughout the organization in the form of expense account padding, falsifying reports, under-ringing sales, abusing the employee discount privilege, and many other dishonest practices.

The climate of honesty within a company has a widespread and pervasive influence on the behavior and attitudes of employees. The pervasiveness of the psychological climate within a company is as pervasive as the physical climate . Temperature, pressure, and humidity affect virtually everything. Likewise, the climate of honesty within a store has a very widespread and general effect on all members of the organization.

Creating a Climate of Honesty

Recruiting and selecting honest employees. The first step in creating a climate of honesty is to staff the organization with employees who possess high levels of personal integrity. The importance of honesty should be emphasized in each step of the selection process. For example, the need for honesty can be emphasized in advertisements about job openings by using such words as "reliable" and "dependable" in describing the type of person being sought.

In states where it is legal, many organizations rely on a pre-employment polygraph to identify individuals who have been dishonest in the past. Prior dishonesty is used to predict dishonesty in the future. When the polygraph exam is conducted by a well-trained operator who takes the time necessary for a reliable exam, a polygraph exam can be a useful method of identifying previous dishonesty. Unfortunately, polygraphs are not a very useful pre-employment screening device because they are only marginally reliable due to their brevity, they are expensive, they are illegal in many states, and, perhaps most importantly, they convey a negative feeling of distrust in the minds of new employees. [9]

A superior method of selecting honest employees is to use a paper and pencil honesty test. Several honesty tests have been developed and the research examining the reliabilities and validities of these tests have generally been quite impressive.

For example, the Applicant Review, an honesty test developed by the authors, can be conveniently administered to job applicants, since it only takes about twenty minutes to administer, and it can be immediately scored by a software computer program.[10]

Perhaps the most important contribution of the Applicant Review to a climate of honesty is the concluding statement which asks applicants to sign their names certifying a willingness to behave honestly toward the company, the customers, and their co-workers. Although this statement seems rather brief and insignificant, it appears to have a significant impact on creating a general expectation in the minds of applicants about the importance of honesty in the company. This simple statement becomes even more important when the job interviewer verifies the signature and looks the applicant directly in the eye and asks, "Are you an honest individual, and can we trust you?" The purpose of this question is not to eliminate dishonest individuals since it is highly unlikely that any applicant would admit to being dishonest and untrustworthy. Instead, the benefit comes from the idea that is planted in the mind of the employee that honesty is important in this organization.

The Consequences of Dissatisfaction

Job dissatisfaction seems to contribute importantly to fraud and a climate of dishonesty. Employees should feel that their pay is fair relative to what others receive for similar work. Pay should be tied to job responsibilities, performance levels, and seniority. When these conditions exist, employees generally think their pay is fair and equitable.

Employees also need to feel that they are being treated fairly in non-financial matters. It is not unreasonable for them to expect their supervisors to treat them with dignity and respect, for vacation schedules and work assignments to be assigned on a non-discriminatory basis, and for fellow workers to extend basic considerations of friendship and kindness. Employees expect not only their immediate supervisor but also their second-level supervisor to know them personally, to observe their performance, and to recognize them for a job well done when they deserve such a reward.

Executives who fail to create conditions of equity and fairness should not be surprised to find that their failure has contributed to serious job dissatisfaction. However, they may be surprised to discover that disgruntled employees are much more prone to employee theft. Although theft is wrong regardless of how unhappy an employee may be, and feelings of dissatisfaction should never be considered a legitimate excuse for being dishonest, still dissatisfied employees tend to use their dissatisfaction as a justification for dishonest behavior.

The disgruntlement explanation for why people steal is easier to understand after looking at the rationalizations employees use for their theft. The following comments by employees attempting to justify their dishonest behavior illustrate the disgruntlement theory:

"I take a little now and then because I deserve it."

"I'm not stealing, I'm just getting even."

"The company deserves it [theft] because they hired Mr. _____, who has to be the world's worst supervisor."

"One day I was so angry I took everything I could get my hands on."

"I was so upset at the way they changed our schedule, that I decided stealing was the only way I could strike back."

Research evidence supporting the disgruntlement theory comes from several of the surveys we have conducted for retail companies using the Loss Prevention Analysis (a questionnaire measuring job attitudes, honesty, and theft). When we have examined the relationships between job attitudes and various measures of honesty and theft, we consistently find significant correlations. Employees who have high job satisfaction and feel they are treated fairly and equitably tend to be more honest with their employer.

## The Benefits of a Code of Ethics

In recent years a growing number of organizations have adopted a formal code of ethics. Some organizations have involved their employees in formulating fairly elaborate codes. Employee participation contributes to more clearly defined standards of ethical conduct.

A major banking institution in the southwest United States spent two years developing a carefully written code of ethics. The decision to develop a formal code of ethics was made by the president of the bank who believed that the process of developing a written code was more important than the final product itself. Consequently, the president initiated the process by a memo which asked managers throughout the bank to write a brief description of some of the most troublesome issues they faced regarding honesty and ethics. This request produced several hundred incidents which were then used by committees to draft a policy statement. The various drafts of the policy statements were circulated among the management team and every manager had an opportunity to respond to multiple drafts as it was refined over a two year period. The president reported that during this two year period measures of theft and fraud within the bank significantly decreased. It was his contention that the open conversations among managers during this period was a healthy process which raised levels of awareness in the minds of managers about honesty and business ethics. At the end of two years, when the final draft was completed, each manager was expected to sign a statement saying that he or she had studied it carefully and was willing to abide by it. The president said that since the process was more important than the product, he anticipated discarding the current code of ethics at the end of two years and starting again.

The value of a code of ethics is that it provides a general definition of honesty which encompasses a broad range of actions. A good code of ethics identifies the general principles employees are expected to follow plus some specific illustrations showing how they should be applied. As unique situations arise, employees are expected to apply the general principles to their specific situations.

Involving Employees in Discussions of Ethical Conduct

Group discussions in which individuals are asked to discuss a question and arrive at a group consensus generally have a large influence on personal values and behavior. Individual behavior is generally influenced much more by consensus group discussions

than by lectures or written communication. The process of developing a code of ethics described above is an excellent illustration of the benefit of group discussions. Those who participated in the committee meetings were forced to carefully examine their own standards of right and wrong and arrive at a group consensus that they considered acceptable both within the company and within society. Research on group decision making suggests that this sort of exercise can be expected to have a powerful influence on changing the personal attitudes and values of the group members.[1]

The benefit of a consensus group decision is also supported by research on the process of moral development. One of the leading theories of moral development suggests that moral values are acquired in a sequential process in which individuals advance from lower levels of moral reasoning to higher and more advanced levels.[2] To explain the development of honesty and moral conduct we have adapted a simplified model which contains three stages: compliance, identification, and internalization, as shown in Figure 3.

At the first stage, <u>compliance</u>, the motive guiding behavior is a concern for being rewarded and avoiding punishment. Individuals who make moral decisions at this stage of reasoning ask themselves the following kinds of questions as they make a moral decision: "Is it legal?" "Will I get caught?" "What will the punishment be?"

At the second stage of moral development, <u>identification,</u> individuals look to the behavior of others to assist them in deciding what is right and wrong. The motive driving their behavior at this stage is a concern for how other people will regard their behavior and particularly how they believe others whom they admire will evaluate them. Here, the rules and conventions of society are especially important as individuals strive to behave in socially acceptable ways. The types of issues that are relevant to someone who is making a moral decision at this stage of reasoning would be such issues as: "What do others do?" "Who will get hurt?" "Who will find out?" "Isn't this an accepted business practice?" "Isn't this what everyone else does?"

At the third and highest level of moral reasoning, internalization, standards of right and wrong have become centered within the individual's own personal value system. The motive that drives behavior at this stage of development is a desire to do what is right based upon the individual's own individually determined standard of proper conduct. Here, individuals base their moral decisions on what they think are universal principles of right and wrong, which they are continually refining and clarifying. At this stage of moral reasoning, the relevant issues in making a moral decision are such issues as: "Is it right?" "Is this what we ought to do?" "How would we want them to treat us?"

Figure 3

Stages of Moral Development

| Stage | Motive Guiding Behavior | Relevant Issues |
|---|---|---|
| 1st Compliance | Obtain rewards and avoid punishment. | "Is it legal?" "Will I get caught?" "What will the punishment be?" |
| 2nd Identification | Obtain approval of people whose opinion is valued. | "What do others do?" "Who will get hurt?" "Who will find out?" "Is it accepted business practice?" "Does everyone else do it?" |
| 3rd Internalization | Act according to individually determined standards of proper conduct. | "Is it right?" "Is this what we ought to do?" "How would we want them to treat us?" |

The process of moving from compliance to identification to internalization depends greatly on individuals thinking about moral issues. Before someone can internalize a standard of behavior, a considerable amount of time must be spent in concentrated thinking that culminates in a personal decision for which the individual accepts a feeling of ownership.[13] Individuals who feel coerced or manipulated by others may willingly comply, but their compliance will not be motivated by

an internal standard that they have created for themselves. One reason why informal group decisions are so effective in influencing values is because (a) they force individuals to think about the issues; (b) they provide individuals with new insight and reasoning; (c) they reinforce change as individuals see others consider change, and (d) they allow individuals the freedom to change at their own rate and in their own direction.

Research on the effectiveness of honesty training such as lectures, sermons, and other formal presentations has generally suggested that such training is largely ineffective.[14]

However, to the extent that individuals are forced to think about honesty and analyze a moral situation, higher levels of honesty have typically been achieved. Some organizations have been moderately successful in raising levels of honesty awareness by meeting with employees in seminars to discuss company policies and practices regarding theft reduction. More research is required to identify the types of seminars and seminar content that are most effective in increasing an individual's commitment to honesty.

Honesty is Acquired

Like other social values, honesty is not an inherited characteristic. It is a value which must be acquired through a process of socialization. The alarming rise in white collar crime and fraud provides overwhelming evidence of the need for greater efforts within society, and especially in business organizations, to teach principles of honesty. According to our research, honesty is developed in an environment characterized by firm expectations and standards of conduct, reinforcement for correct behavior, disapproval for wrong behavior, the presence of love and concern by important people, and an emphasis on the development of discipline and self control.[15]

## REDUCING FRAUD

The three factors discussed above provide a useful framework for diagnosing and taking corrective action to reduce fraud. In short, fraud is reduced by eliminating the pressures and opportunities to commit fraud and by increasing personal

integrity. If organizational leaders are sufficiently concerned about the possibilities of fraud within their companies, there are several actions they can take. The following ideas are possible actions for managers to consider. Some factors, such as executive disclosures, may not be very popular. Managers should only adopt changes that seem necessary for their situation. As the potential losses from fraud or the opportunities to commit fraud increase, additional factors should be considered.

Reducing Situational Pressures

In the free enterprise system it is not possible or even desirable to eliminate all situational pressures. While a moderate level of pressure on individuals, departments, and companies is desirable, at times the pressures become overwhelming. Escape outlets, like pressure valves, need to be provided.

Avoid setting unrealistically high performance expectations. Companies that set arbitrary goals for increased earnings, sales, or profits with a "do it at any cost" attitude encourage managers to behave dishonestly, especially during times of economic downturns.

Remove unnecessary obstacles. Unnecessary obstacles, such as insufficient working capital, excess capacity, and obsolete equipment or inventory that block effective performance need to be removed. Severe obsolescence of equipment and personal skills can be avoided with adequate planning. Similarly, insufficient working capital and excess production capacity are also created by poor planning. Good forecasting and advance preparation can also minimize some of the pressures created by cost increases, difficulty in collecting receivables, unusually heavy competition, or IRS tax adjustments.

Provide personal counseling. Personal counseling may be necessary to help employees with financial problems. Employee assistance programs in many companies have been very effective in helping employees deal with personal problems. Alcoholism, drug abuse, marital problems, and gambling often create financial problems and reduce work effectiveness. These intense pressures, which often lead employees to commit fraud, can be reduced by an

effective assistance program that helps employees manage their finances and redirect their lives.

Establish fair and uniform personnel policies. Fraud has occasionally been committed by employees because of feelings of revenge or resentment toward their superiors. Because employees feel underpaid, passed over for a promotion, or unfairly treated, some defraud their company, believing that they are only getting even. In one, a manager chose to ignore a $2,500 per year theft from the petty cash account because he felt the employee was underpaid by at least $5,000 per year.

Reducing Opportunities

An elaborate security system and tight internal controls are usually considered a necessity for reducing fraud. While such programs are not the total solution, fraud can be reduced by making it more difficult to commit or hide. The following factors should reduce the opportunities to commit fraud.

Carefully monitor business transactions. Interpersonal relationships and business transactions with suppliers, buyers, purchasing agents, sales representatives, and others who interface in the transactions between financial units need to be carefully monitored. These individuals are constantly faced with situations in which subjective business decisions can easily result in illegal bribes, kickbacks, and payoffs or in favors and gifts that might be unethical even if they are legal.

Maintain accurate and complete internal accounting records. The accounting department needs to be adequately staffed with competent professionals. The internal accounting system must be carefully designed to monitor all business transactions and operate efficiently with timely and accurate reports.

Establish a physical security system to secure company assets, including finished goods, cash, equipment, tools, and other items of worth. A good security system requires a detailed analysis of the company's physical assets and flow of materials. Fraud is especially troublesome during transportation and at loading docks.

Avoid over-reliance on one individual. Do not rely solely on one individual to perform an important function. The

opportunity to commit fraud is especially prevalent when one employee has total control over an operation that no one else observes or understands. Computer operators are particularly capable of committing fraud because they can hide their actions and few people really understand what they do. Many computer-related frauds have been discovered only by accident, such as the Union Dime Savings Bank teller who embezzled $1.5 million over several years and was only detected after a gambling raid when someone became suspicious of how he could bet $30,000 daily on an $11,000 annual salary.

Executives and other key employees are also capable of controlling a single function that enables them to embezzle funds. To reduce this problem, executives should be required to take an annual vacation during which time other individuals perform their functions. Job rotation and temporary assignments are also useful to teach other employees how to perform important functions and act as a check against improper actions.

Maintain accurate personnel records regarding the previous backgrounds and current financial activities of employees. This information might include employees' criminal or police records, improper actions on their present jobs, statements from previous employers, evidences of living beyond their present levels of income, expensive habits or tastes, and even a complete financial disclosure of personal wealth. Requiring each employee to make a full financial disclosure each year is not a popular practice. While some might consider it an invasion of privacy, key executives and individuals who hold important positions of trust would probably understand the need for financial disclosures and realize that instances of material fraud should become apparent.

Develop strong leadership and cohesive work groups. Each employee should feel a personal identity with a work group directed by a capable leader. Internal controls and company procedures can be enforced tactfully and fairly through effective supervision. Identification with a cohesive work group reduces the tendency to think in terms of a large, impersonal corporation in which fraud would not be hurting any individual. Strong leadership also creates a greater awareness of personal problems and other situational pressures that can lead to fraud.

Strengthening Personal Integrity

Regardless of the situational pressures and opportunities to commit fraud, the dishonest act of fraud is still committed by an individual, and society holds that individual accountable for his behavior. As individuals adopt and internalize a high standard of personal integrity, the probability that they will commit a fraud is reduced.

Teach by precept and example. Research suggests that induction and modeling are effective techniques for developing moral behavior.[16] Induction refers to teaching and explaining, encompassing all forms of instruction, including lectures, group discussions, written material, casual comments, or "thoughts for the day." Modeling refers to the example set by important individuals, such as organizational leaders or close co-workers. If top management is dishonest in their dealings with the public or government agencies, other members of the company are more inclined to be dishonest as well.

Define dishonesty. Honest and dishonest behaviors need to be defined. For example, most purchasing agents would agree that accepting a $5,000 bribe from a supplier is dishonest, but a weekend vacation at a hunting cabin is not as clear-cut. A major cause of dishonesty comes from rationalizing and redefining the situation and it is natural for the criterion of expediency to replace the criterion of right versus wrong. To avoid this problem it is necessary to set explicit standards of conduct and general principles of behavior. Many corporations have recently adopted an explicit code of conduct that managers are required to read, sign, and follow.

Select honest employees to occupy positions of trust. As noted earlier, several instruments have been designed to measure the personal integrity of job applicants. Evidence shows that these scales can reliably predict personal integrity. In the employment interview, candidates could be directly asked if they are honest and trustworthy. Such a question signals to the candidate the importance of honesty to the company.

Reward employees for reducing theft. To enlist the cooperation of their employees in reducing theft, some companies

offer financial incentives. One type of incentive is essentially a bounty for employees who report thefts by other employees. When other employees are observant, it is difficult for an employee to commit a theft entirely unnoticed. To reduce the stigma associated with being a "whistle blower," companies frequently provide an opportunity for such individuals to remain anonymous to the extent that anonymity is possible.

Perhaps the most effective form of financial incentives for improving honesty is a profit-sharing arrangement in which all of the employees are rewarded for a reduction in inventory shortages. Some organizations have successfully used this approach by identifying a target level of inventory shortages, such as 2.5 percent, which is usually less than their current rate. When the shrinkage rate falls below 2.5 percent, 50 percent of the savings to the store is placed in a profit-sharing fund and distributed to the employees. Such a profit-sharing program has the advantage of rewarding employees for their own honesty, plus it also rewards them for being conscientious in handling merchandise, processing paperwork, and reducing costs.

Evaluate employee performance. Performance evaluation is a central element in the employment exchange between the employer and employees that contributes to a climate of honesty when it is properly performed. Employees work for an organization in exchange for the compensation and benefits they receive. Employees must perceive that there is a fair exchange between the contributions they make to the organization and the inducements they receive in exchange. Employees expect to have their performance evaluated, and their pay should be commensurate with their performance. Periodically, at least once a year, the immediate supervisor of each employee should compile information regarding that employee's performance and review this information with the employee. Individuals who have not performed adequately should be better trained or better motivated to improve their performance. Those who have performed well should receive pay increases and be lavishly praised for their contribution. The annual performance appraisal interview is an appropriate time to reaffirm the importance of honesty by asking employees if they

have been totally honest with the company, the customers, and their co-workers during the past year, or if they need to make restitution for any wrong-doing. Although asking such a question about a person's honesty is a rather sensitive issue that may create discomfort for supervisors, it is still an important question which can have a positive influence on creating a climate of honesty. If employees know that at least once a year they are going to be asked point blank, "Have you been totally honest in your dealings with this company," there is a greater likelihood that at times when they are tempted to behave dishonestly they will think twice about doing it. As we have asked individuals how they would respond to such a question during a performance appraisal interview, it has been our experience that about three-fourths of the people report that they would not be offended by such a question. Some individuals have even responded by asking why such a question is not already routinely asked if honesty is really so important to the organization.

Develop an organizational climate that emphasizes the importance of honesty. Such a climate can be established through subtle methods, such as identifying and acknowledging top management's errors, or through explicit methods, such as a formal presentation included in a new employee orientation program. Top management should make it clear that honest reports are more important than favorable reports.

Prosecute fraud. The consequences of violating the rules and the punishment of fraud perpetrators should not be kept secret. Even though white collar crime is an embarrassment to a company, failing to uncover fraud and prosecute offenders contributes to its increase. Employees who have been quietly dismissed for fraud in one company often go to another company and continue their dishonest ways. The general perception on the part of most individuals is that many white collar crimes, especially computer frauds, are never discovered. When frauds

are discovered, the offenders are often not prosecuted, or if prosecuted, the penalties are not very heavy. In general, these perceptions are correct. While severe penalties do not totally eliminate white collar crime, the severity of the penalty does act as a deterrent.

## A UNIFIED ASSAULT ON FRAUD

Most previous suggestions for reducing fraud have focused on eliminating the opportunities to commit fraud through tighter security. Long lists of suggestions have been compiled describing elaborate physical security systems and internal accounting control systems. Such programs should definitely reduce fraud, but they are not the total solution to the problem. The model described earlier suggests that fraud may still occur even though external security and internal controls appear to eliminate opportunities. If individuals are dishonest or have sufficient need, they will create their own opportunities. A reduction in fraud requires a combined thrust to reduce simultaneously the opportunities and situational pressures to commit fraud and to increase personal integrity.

A successful assault on the fraud problem cannot rely solely on the accounting profession. The suggestions listed above clearly illustrate how management has the capacity either to reduce or increase fraud by the policies and procedures adopted. Regardless of whether their influence is intended or unintended, the behavior of managers can increase or decrease the likelihood of material fraud. While managers may be reluctant to perform the role of a social moralist, it is obvious that their actions exert a powerful influence on the behavior of organizational members. Since honesty is such a widely accepted social value and the costs of fraud are enormous, it is imperative that managers assume a greater responsibility for affirmative actions that reduce fraud. Corporate leaders should join the accounting profession and other social organizations in launching an assault on the problem. Effective changes in auditing and business practices, when reinforced with supportive organizational and social changes, can significantly reduce fraud.

**Endnotes**

1. The research team consisted of W. Steve Albrecht and Marshall B. Romney of the Institute of Professional Accountancy, Brigham Young University; David J. Cherrington, Department of Organizational Behavior, Brigham Young University; I. Reed Payne, Department of Psychology, Brigham Young University; and Allan V. Roe, Psychologist, Utah State Prison.

2. W. Steve Albrecht, Marshall B. Romney, David J. Cherrington, I. Reed Payne, and Allan V. Roe, How to Detect and Prevent Business Fraud. Englewood Cliffs, NJ: Prentice Hall, 1982. Appendix C.

3. Marshall B. Romney, W. Steve Albrecht, and David J. Cherrington, "Auditors and the Detection of Fraud," Journal of Accountancy. May 1980, pp. 63-69.

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7. David J. Cherrington and J. Owen Cherrington, "The Climate of Honesty in Retail Stores," Journal of Security Administration Vol. 5, No. 2, 1982, pp. 37-52.

8. These stores were department stores of comparable size and merchandise offerings located in three geographical regions of the United States.

9. For a review of polygraph research, see John E. Reid and F. E. Inbau, Truth and Deception: The Polygraph ("Lie Detector") Technique. Baltimore: Wilkins and Wilkins, 1966.

10. Information about this questionnaire and other questionnaires identified below can be obtained from CHC Forecast Inc., University Station, PO Box 7209, Provo, Utah, 84602. Test/retest reliabilities and information about validity studies will be provided upon request.

11. Kurt Lewin, "Group Decision and Social Change." In G. E. Swanson, T.M. Newcomb, and E. L. Hartley (Eds) Readings in Social Psychology. New York: Holt, 1952, pp. 459-473.

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13. David J. Cherrington, Rearing Responsible Children. Salt Lake City, UT: Bookcraft Pub., 1985.

14. Hartshorne and May, op. cit.

15. Diana Baumrind, "Effects of Authoritative Parental Control on Child Behavior," Child Development, Vol. 37, 1966, pp. 887-907.

16. Martin L. Hoffman, "Moral Internalization, Parental Power and the Nature of the Parent-Child Interaction," Developmental Psychology, Vol. 11, No. 2, 1975, pp. 228-239.

Senator BIDEN. Mr. Carlson, why don't you make your statement, and we will go to questions.

## STATEMENT OF KENNETH E. CARLSON

Mr. CARLSON. Thank you, Senator. I also have been fascinated by the testimony that's gone before, and I am grateful for the opportunity to be here and hear it and to address the committee.

I am going to describe a study that was conducted for the Internal Revenue Service which addressed the amount of tax loss due to people who defrauded the IRS for reasons that are not at all subtle. They were the people who didn't want to write "bank robber"on their Form 1040, or who were selling drugs and didn't think it was a good idea to keep a record of that fact.

The principal topic of our study was activities which were in themselves illegal, and which, because of their illegality, additional resulted in a tax fraud.

Senator BIDEN. Things that were in and of themselves illegal; ergo, they were not disclosed, and therefore——

Mr. CARLSON. And therefore were not going to be reported for tax purposes.

I agree with your observation that general tax fraud seems to be increasing. IRS are data and indirect measures confirm that. I don't know if it's exactly over the last 20 years, but between two measurements about that far apart the compliance rate appears to have gone from about 94 percent of all filers to about 82 percent of all filers.

So there is a dramatic——

Senator BIDEN. It amazes me, people who are so, by every other measure, honest and upstanding citizens, that you know personally—I imagine we all know them—who will say and do things relative to their declaration relating to their tax form, that you say—when I practiced law, I'd say, but Charlie, that's illegal, that's wrong. Yeh, it may be technically illegal, but—and they really seemed, self-rationalization or not—I think a lot of them believe it, you know: what's being done to me under the tax system is wrong; ergo, I don't have to pay any.

Mr. CARLSON. One of the other findings from our study, combined with other studies of the IRS, is that the illegal sector activity is an order of magnitude smaller than the so-called legal tax fraud.

Most transactions in the underground economy concealed only to evade taxes. I am talking today however, about the smaller part, the activities which are completing illegal, even apart from tax considerations.

I am going to summarize the national scope of illegal activity, and then make a few comments about what the exercise of trying to produce those numbers taught us about the difficulties of measuring and understanding the underground economy.

In any other town the numbers that I am about to give would be considered very large; in Washington I am sure they are workaday figures.

Senator BIDEN. If it's under half a trillion——

[Laughter.]

Mr. CARLSON. Well, the total underground activity in the country is probably just barely within that limit. Based on the estimated nonreporting rate for legal plus illegal activities, applied to this year's GNP, we would guess that somewhere in the neighborhood of $240 billion, plus or minus about $80 billion, appears to be off the books in some way or other.

Senator BIDEN. Off the books because it is already illegal activity?

Mr. CARLSON. No, this is now the total of underground activity, including legal transactions that are not reported, wages that come in forms other than money and don't show up, unreported barter and so on.

In the illegal sector, we estimate a total of about $80 billion. This total is based partly on our estimates and partly on summaries of other sources. The error factors in the estimates are not always well documented.

The main component of the illegal sector that we measured was crimes where all parties consent—the sale of drugs, gambling, prostitution. Those three combined were worth about $35 billion in 1982. We think that the error in this estimate is probably at least $9 billion.

Of the 35, drugs are about two-thirds. These estimates of income from drug trafficking are substantially lower than many that have been published, for a variety of reasons. One reason is that we are looking specifically at income, not at the street value of drugs. Many drug transactions take place at values that are far below street value.

Also we have used what we think are more careful, and are certainly more conservative, assumptions about the level of use, particularly among occasional users.

Senator BIDEN. This is $35 billion otherwise taxable income?

Mr. CARLSON. Otherwise taxable income.

Senator BIDEN. Not lost taxes.

Mr. CARLSON. Right. The other substantial components in our estimate of illegal income are thefts from households, inventory shrinkage in businesses, and thefts in shipping of cargo. Those thefts all combined are about $11 billion, plus or minus about a billion.

They are somewhat easier to measure because the incentives to report a theft, either to an interviewer or to the police, are much higher than the incentives to report something like a drug transaction.

In these cases a party to the transaction gives us an account of what occurs.

We looked at a number of illegal activities, which, involve another form of white-collar crime in addition to tax fraud. In particular, we looked at Government benefit frauds. This has some bearing, I think, on the question of whether the perceived value of the service that is being delivered is a deterrent to cheating. We found Medicare provider fraud produced a billion and a half dollars in income. Medicaid providers made $0.7 billion by fraud. Those two together are substantially larger than frauds committed by beneficiaries of the service.

There are many unscrupulous people willing to turn even essential medical services to their own ends.

In total, we found Government benefit frauds of about $4.5 billion. In the context of the underground economy, this is a small fraction of the total.

Among non-Government frauds we estimate $1 to $2 billion worth of income from bad checks and check forgeries, and about $300 million of embezzlement from banks. Others have estimated $3 to $10 billion of income transactions from bribery and corruption.

There are limits to what this tells us about the scope of the underground economy. The main one is a definitional problem. The term white-collar crime, when originally introduced by Professor Sutherland, referred to a characteristic of the perpetrator. He originally studied corporations which engaged in illegal activities. Since that time, the term has been vastly broadened, and sometimes completely reversed. I've encountered sources which defined white-collar crime as crime against corporations.

There is no universally accepted definition of the term. Any estimate of the scale of white-collar crime depends on who's counting and what's being counted.

Most estimates are constructed by adding an aggregate of components. Every published list of components is different from the others. In the literature we find a wide range of dollar amounts attributed to white-collar crime. The main reason they disagree is they are talking about different sorts of crime.

For my own work I have found the global rubric of "white-collar crime" to be not very useful. Essentially, if you want to talk clearly about something, you have to make a short list of the kinds of offenses that are being addressed and say what you can about those. As a result, omissions are inevitable.

Some of the major omissions from over estimates of the white-collar crime scale include consumer fraud, on which we know very little, because it's so diverse and because victims are often unaware that they are victims, so we have no idea of the scope of detectable and undetectable consumer fraud. Others have published estimates ranging from $20 to $30 billion.

A second problem of estimation is detection. With most ordinary thefts it is easy to tell that a theft has occurred. Even though half of them may not be reported to the police, we generally believe that the high-value incidents show up somewhere.

With a white-collar crime it's often hard to tell whether a particular action is a crime. Deciding criminality may require litigation or interpretation, it involves the kind of data that Professors Wheeler and Cressey talked about the perpetrator controlling of, and, as long as he can control those data, it may be impossible for the rest of the system to determine that something was a crime.

The second detection problem is that the data sources are almost invariably indirect. For example, our estimates of Government benefits frauds, those estimates are based primarily on audits of error, most of which is not fraud. Most of the Government programs that we looked at collect data to control their own operations and provide quality control on their own error. In that process they detect a certain number of frauds, which we can have data on but essen-

tially we are assuming that statistics that are valid for error can be combined with statistics that are valid for fraud to produce a total estimate of fraud.

Almost all of the estimates of white-collar crime and of other offenses that we produced are based on compounded assumptions of that nature.

A third difficulty of measurement is that white-collar crimes are often diffuse. There may be very large numbers of victims, each contributing a very small share of the offense. This means that many sources of data are required, and that many judgmental assumptions are involved in the estimates.

The final problem is caused by rare but extremely large crimes. I have looked at some data similar to those that Professor Wheeler analyzed of defendants prosecuted in the Federal system. One of the preliminary findings from those data appears to be that, although 95 percent of the defendants are committing crimes worth less than $1 million, about 97 percent of the dollars are in the crimes above $1 million. That means that data on a very large number of offenders are required to provide enough of the important ones to estimate the amounts. I think that has important implications both for how we measure the scope and perhaps also for the motivations for attacking different ends of the spectrum.

One conclusion we derive from this statistic is that typical values in a statistical sense are nonexistent for the theft loss of white-collar crime. The means are entirely driven by the $100 million thefts. The medians are entirely driven by the $5,000 ones. And neither one is representative of the true scope of the problem.

Consequently, large part of the compounding assumptions which multiply a typical value for a crime by some guess at the number, are rendered highly suspect by the extreme skewness of the distribution.

On the other hand, there may be some good news for estimation in that finding—most of the economic value is in major offenses. Reporting and detection are surely more probable for these than for the many lesser offenses. Consequently, coverage of economically significant white-collar crime, both by data sources and by law enforcement, may be much higher than is commonly believed.

Senator BIDEN. Excuse me for interrupting. Those five buzzers we are about to hear mean that there is a vote on the floor and I have 7 minutes to make it there and vote.

Let me ask you your collective preference here. It will take me at least 10 to 12 minutes to get over, vote, and come back. I kept you longer than you anticipated. I am prepared to come back and continue—but it will be no problem for me to submit to you questions in writing from here.

I don't ask you to make that judgment now. I have to leave and go vote. If you will let Professor Blakely know what your preference is, I will call before I come back. If in fact you have planes and trains and engagements to meet, then, fine, I will submit them in writing; if you don't, I can keep you for another half hour or so.

But it's up to you. And I must go. I apologize. And you have really gotten the short end of this today; I didn't know there would be a vote now—but I must run and vote. And I will be back, de-

pending on your inclination. I will not be offended if you have to go, but I am prepared to ask questions, if you are here.

Thank you.

[The committee adjourned at 4:03 p.m.]

[Prepared statement follows:]

STATEMENT

OF

KENNETH E. CARLSON
ABT ASSOCIATES INC.

## Introduction

The data I am presenting today are part of an attempt to measure the extent of illegal economic activity in the United States. They are drawn principally from a study commissioned by the Internal Revenue Service which we completed in September, 1984. In addition, I will cite some more recent work by other researchers which updates certain sectors of our analysis. I will first briefly describe our results and how they were obtained, then try to place these in the general context of the underground economy. I will conclude with a few observations on the problems of estimating the extent of clandestine activity and their implications for the reliability of data such as ours.

Our study was part of a larger effort by the IRS to estimate the entire scope of unreported taxable income. This purpose led us to impose the following restrictions of scope on our estimates:

1. The activities covered by the study had to involve crimes in addition to tax evasion. For example, income from the sale of illegal drugs was included; unreported income from the sale of legal products or services was not.

2. Income had to be mostly unreported for tax purposes. This would exclude certain complex major offenses such as criminal antitrust violations, some government procurement frauds, and other offenses where the income itself would be highly visible although the illegal part of the behavior was concealed.

3. The accounting basis for the estimates was net taxable income, as opposed to victim loss or national product. Theft, for example, is a transfer which contributes income to the thief but leads to no product. Because the value of stolen goods is discounted, income to the thief is substantially smaller than loss to the victim.

## Summary of Results

Tables 1 to 3 and the associated figures show our estimates of the illegal income derived from the activities covered by our study. For 1982 (the latest year for which sufficient data were available) these crimes contributed an estimated fifty two billion dollars of income, of which only ten percent could be classed as white collar crime. We know this enumeration to be incomplete, however. Major crime categories were not addressed at all under the scope of our study. Various sources have published estimates of consumer frauds in amounts ranging from twenty one to twenty seven billion dollars. The margin of error in this estimate exceeds the income from all frauds covered in our study. Income tax evasion by firms and persons engaged in otherwise legal activities are perhaps the largest single source of white collar crime. The IRS estimates that between four and eight percent of the Gross National Product improperly escapes taxation. Applied to the 1985 estimated GNP, this rate would imply $240 billion of untaxed legal sector income (plus or minus $80 billion) with an associated tax loss of about $64 billion (plus or minus $20 billion).

Table 1

Unreported Illegal Income
from
Crimes of Consent
(Billions of Dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| Drug Sales | $6.32 | $9.28 | $20.63 | $22.15 |
| (standard error) | ($2.00) | ($2.88) | ($5.72) | ($5.97) |
| Heroin | 2.78 | 3.95 | 5.59 | 6.12 |
| Cocaine | 2.31 | 3.53 | 9.64 | 9.93 |
| Marijuana | 1.23 | 1.80 | 5.40 | 6.10 |
| Gambling | $0.86 | $1.25 | $1.80 | $2.39 |
| (standard error) | ($0.21) | ($0.32) | ($0.58) | ($0.77) |
| Numbers | 0.44 | 0.74 | 1.21 | 1.60 |
| Horses | 0.20 | 0.24 | 0.26 | 0.35 |
| Sports | 0.19 | 0.25 | 0.32 | 0.42 |
| Casinos | 0.02 | 0.02 | 0.02 | 0.02 |
| Prostitution | $2.64 | $3.79 | $6.18 | $11.58 |
| (standard error) | ($1.47) | ($2.29) | ($3.44) | ($6.54) |
| Streetwalkers | 0.27 | 0.38 | 0.62 | 1.16 |
| Massage | 1.29 | 1.85 | 3.01 | 5.65 |
| Call Girls | 0.38 | 0.54 | 0.88 | 1.66 |
| Bars & Hotels | 0.71 | 1.02 | 1.66 | 3.12 |

Table 2
Unreported Illegal Income
from Crimes of Theft
(Billions of Dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| THEFT | $4.43 | $5.67 | $8.68 | $10.38 |
| (Standard Error) | ($0.40) | ($0.53) | ($0.78) | ($1.09) |
| Household Sector | 1.38 | 1.92 | 2.67 | 3.89 |
| Retail Sector | 2.49 | 3.16 | 5.00 | 5.30 |
| Transportation | 0.31 | 0.36 | 0.55 | 0.55 |
| Other Businesses | 0.25 | 0.23 | 0.45 | 0.64 |

Table 3
Illegal Income from
Selected White Collar Offenses
(Billions of Dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| Selected White Collar Offenses | $1.52 | $2.53 | $3.28 | $5.29 |
| Private Sector | $0.42 | $0.39 | $0.47 | $0.78 |
| (Standard Error) | ($0.05) | ($0.05) | ($0.09) | ($0.15) |
| Arson for Profit | 0.05 | 0.08 | 0.16 | 0.29 |
| Bank Embezzlement | 0.15 | 0.15 | 0.12 | 0.28 |
| Counterfeiting | .00 | .00 | .00 | 0.01 |
| Cigarette smuggling | 0.22 | 0.15 | 0.19 | 0.20 |
| Welfare Frauds | $0.29 | $0.74 | $0.74 | $1.15 |
| (Standard Error) | ($0.04) | ($0.10) | ($0.09) | ($0.18) |
| A F D C | 0.05 | 0.09 | 0.22 | 0.22 |
| Food Stamps | 0.15 | 0.36 | 0.29 | 0.45 |
| S S I | 0.00 | 0.01 | 0.01 | 0.02 |
| Unemployment | 0.10 | 0.28 | 0.21 | 0.45 |
| Health Care | $0.81 | $1.40 | $2.08 | $3.37 |
| (Standard Error) | ($0.24) | ($0.41) | ($0.62) | ($1.01) |
| Medicaid | | | | |
| Beneficiary | 0.32 | 0.52 | 0.76 | 1.18 |
| Providers [a] | 0.21 | 0.35 | 0.45 | 0.72 |
| Medicare [a] | 0.28 | 0.53 | 0.87 | 1.47 |

[a] These estimates include both reported and unreported illegal income. The IRS estimates that approximately 75 percent of this amount is actually reported.

Incomplete enumeration is only one of the sources of uncertainty in these estimates. Displayed under each major subtotal in the tables is an estimated standard error. This number reflects several types of uncertainty in our estimates. Estimates of the number of offenses or offenders are always based on samples. This introduces two sources of error. The sample estimates of incidence will generally differ from those for the population from which it is drawn because of random error. Moreover, the sampled population may not represent the real population because important members are selectively hidden from sampling. For example, surveys of drug users exclude military bases, correctional facilities, and nursing homes, all of which surely have non-average drug use characteristics.

In most of the estimates, a measure of incidence is multiplied by an average monetary value for the offense, which is often even less accurate than the incidence estimate. For example, in estimating average fraudulent AFDC payments, we assumed that the average fraudulent claim was probably less in value than average total benefits, but greater than average error overpayments. This assumption was based only on anecdotal evidence, since no scientific measurement was available.

Further uncertainty was introduced by the conversion of gross loss estimates to illegal income. Many illegal activities involve expenses, some of which may be a substantial fraction of the income. Gambling may be the most dramatic example of this. Depending on the game, between forty and ninety five percent of total wagers will be paid back to winning betters. Dramatic estimates of the size of the underground economy have been produced by counting gross handle instead of net take in gambling enterprises.

## Problems of Measurement

Four major facts contribute to the difficulty of measuring white collar crime. The wide divergence of estimates now in the literature is largely due to these problems.

1. Scope. Most recent work, including ours, has followed the approach of enumerating specific offenses and attempting separate microeconomic estimates for each. Given the diversity of white collar crime, all of these enumerations will be incomplete. Some of the disagreement among sources reflects differences in the list of omitted offenses.

2. Detection. By its nature, white collar crime is more difficult to detect than most other types of offense. In some cases, even though some facts about an act may be publicly known, it may still be difficult to determine whether the act was criminal. Since the crimes often involve the manipulation of information, direct measurement sources cannot usually be relied upon to give useful estimates of the extent of the offense.

3. Diffuse nature of the offense. Each victim of a major offense may lose only a small amount, or may lose it so indirectly that he or she is unaware that a crime has occurred. This means that estimates are generally derived from combining many (possibly incompatible) sources, and necessitates judgmental adjustments to correct incomplete coverage.

4. Skewness. Data on Federal prosecutions of white collar crime suggest that 95 percent of defendants are accused of offenses with an average value of less than one million dollars. More than 95 percent of the money, however, is attributable to the remaining five percent of million dollar plus crimes. This has a number of implications both for measurement and policy. First, it means that anecdotes about a laundry list of heinous offenses contribute practically no information about typical offenses. Statistical average and median values, unless based on very large and representative samples, do little better, since only the top one-twentieth of the sample will contribute to the average, and the median will ignore these cases entirely.

## Conclusion

Total illegal income in the United States is an economically significant amount. Most of the underground economy, however, consists of activities which are themselves legal, but which are concealed to evade taxation.

Of non-tax crimes which have been studied, commercial vice appears to contribute the major share of illegal income. The white collar crimes included in our study are an order of magnitude smaller than common street crime.

Most of the economic value of white collar crime is concentrated in a comparatively small stratum of multi-million dollar offenses, which are not typical of most white collar crimes. Although white collar crime is both widespread and economically significant, the part that is economically significant is not widespread, and the part that is widespread is not economically significant.

## Response to Questions

1. Would you explain the reasons for having chosen not to make a global estimate of illegal income?

Two approaches have been used by others to construct global estimates of illegal income: complete enumeration, and macroeconomic estimation. A bibliographic summary of macroeconomic approaches is provided by Carol Carson in "The Underground Economy: An Introduction." (Survey of Current Business, May, 1984.) We chose not to use macroeconomic methods because in our judgment they rely on a number of methodological and substantive assumptions which are extremely difficult to believe. On the other hand, we did not regard our enumeration as sufficiently complete to justify presenting it as a measure of the entire illegal sector of the underground economy. At some future point research on economic crime may be sufficiently complete to permit meaningful aggregate statements, but in the present state of knowledge, all estimates must be regarded as partial.

2. Should we resist the attempt to put overall figures on White-Collar crime?

We have not found this level of aggregation generally useful. The range of offenses covered by the White-Collar rubric is extremely diverse, both behaviorally and economically. The term includes acts ranging from making false statements on applications for government benefits, to criminal antitrust.

From an economic point of view, the offenses are dominated by a few multi-million dollar frauds; to a sentencing judge, the caseload consists mostly of poorly educated, distinctly non-white-collar defendants caught in small peculations.

In general, the data sources, and even accounting categories, which are appropriate to describe or estimate one class of white collar crime may be unavailable or inapplicable to another class. The victims form conceptually disparate groups: a level of government, a class of business competitors, consumers, a bank. Different classes of offense surely call for different remedies.

To answer any practical question about prevention, sentencing, harm, or other effects, our first step is to ask, "Which white collar crime?" While the general term may be a useful conceptual beginning point, it is of little subsequent practical value. Given the measurement problems enumerated in my statement, producing a credible overall figure is probably more trouble than it is worth.

3. Please indicate what, if anything, you did to estimate the size of:
   - environment fraud or toxic waste
   - drug fraud
   - price-fixing
   - securities fraud
   - commodities fraud
   - defense fraud
   - consumer fraud

These, and some other crimes, were not included in our study because we felt most of the income generated by the crimes would be reflected in the regular income statements of the perpetrators, and thus probably was not evading taxation. There are surely exceptions. A producer of toxic wastes might give fifty dollars to "a guy with a truck" to dump a load of unlabeled drums at some deserted roadside. Such a transaction probably goes unrecorded and untaxed. In general, however, we felt that the nature of these offenses made it likely that even illegally earned income would be taxed.

- insurance fraud

Arson for profit is covered in our report. We attempted to obtain data from insurance professional organizations to estimate certain other types of fraud, but were unsuccessful because these data were regarded as proprietary.

- bank fraud

We could only find data on officially reported incidents. We believe non-reporting is common industry practice, and were unable to locate any data source which might allow us to estimate its extent.

- tax fraud

Our project was a component of a larger Internal Revenue Service study which did produce estimates of tax fraud. (U. S. Department of the Treasury, Internal Revenue Service, Income Tax Compliance Research: Estimates for 1973-1981, 1983.) Table 4 (reproduced from an unpublished paper by Ann D. Witte, April, 1985) shows the estimates of untaxed income reported in this study.

Table 4
Legal Source Incomes
(Millions of Dollars)

| | 1973 | 1976 | 1981 |
|---|---|---|---|
| Individuals | | | |
| Wages and Salaries | $33,304 | $46,247 | $94,581 |
| Dividends | 1,920 | 3,638 | 8,747 |
| Interest | 4,440 | 6,763 | 20,479 |
| Small nonfarm enterprises | 23,906 | 32,565 | 58,400 |
| Farm proprietors | 5,742 | 4,542 | 9,587 |
| Informal income suppliers | 10,364 | 12,721 | 17,080 |
| Rents | 1,335 | 2,390 | 3,049 |

| | | | |
|---|---|---|---|
| Royalties | 312 | 1,088 | 2,770 |
| Estate and Trust income | 487 | 695 | 1,330 |
| Overstated business expenses | 5,250 | 8,500 | 16,179 |
| TOTAL | $87,060 | $119,149 | $232,162 |
| Corporations | $8,140 | $10,390 | $14,188 |
| low estimate | $6,912 | $8,833 | $11,968 |
| high estimate | $9,368 | $11,947 | $16,407 |
| Taxable income of tax exempt organizations | $91 | $203 | $291 |
| low estimate | $68 | $152 | $218 |
| high estimate | $113 | $253 | $363 |
| Fiduciaries | $110 | $112 | $288 |
| low estimate | $82 | $84 | $216 |
| high estimate | $137 | $140 | $360 |

- money laundering

This was not estimated separately because laundering is usually an adjunct to some other offense, such as drug sales. As far as we could determine, the only data available on money laundering concerned the tactics of the transactions, and not their aggregate volume.

- health care

Medicare and Medicaid are covered; insufficient data were available to deal with other forms of fraud. We assume these to be largely reported for tax purposes, and thus outside the scope of our 1984 study.

- bankruptcy fraud

Insufficient reliable data.

- bribery

Insufficient reliable data.

- embezzlement

We were able to locate reliable data only for banks (and other FDIC-insured institutions). These are included in the estimates in Table 3 above.

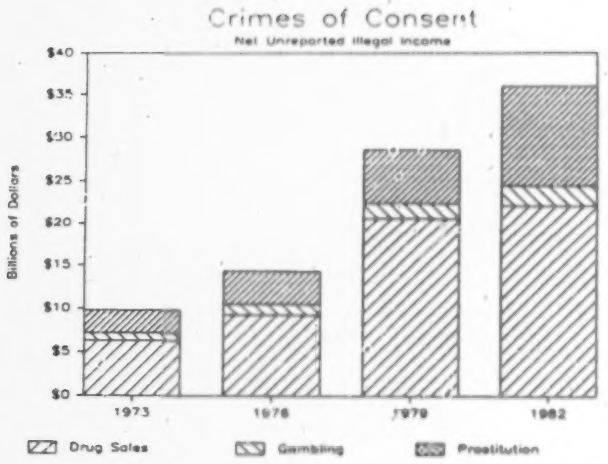
4. Would you explain how your approach differed from similar efforts by the Department of Health and Human Services to estimate medical fraud?

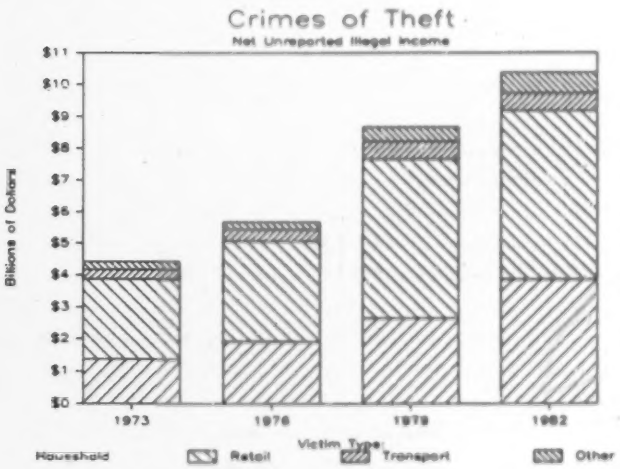
Our estimation methodology for this category is attached. (Appendix A) Our estimates do use data from the Office of the Inspector General of the Department of Health and Human Services covering fiscal year 1977. The subsequent OIG reports which were available to us at the time of the study were neither as detailed nor as comprehensive as the 1977 report, and could not be used for our estimation purposes.

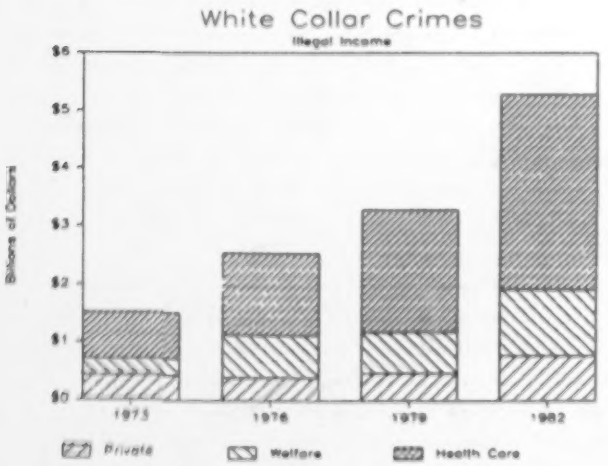
We considered using error rates compiled by the HCFA Bureau of Quality Control. These error rates, however, reflect primarily mistakes discovered during claims processing reviews, and have little, if any, bearing on fraud.

5. Do you understand that there is now agreement between the Internal Revenue Service and the Drug Enforcement Administration on your estimates of the drug traffic?

During the period while our study was in progress, IRS, DEA and we worked closely together. Most of the assumptions behind the DEA estimates for those years were shared by the IRS and us. (A few minor unresolved differences remained.) As far as I am aware, the IRS has made no subsequent estimates of drug traffic. Subsequent DEA publications do not provide enough information about estimation methods to support an informed judgment about their methodological validity.


Crimes of Consent
Net Unreported Illegal Income
Billions of Dollars
$40
$35
$30
$25
$20
$15
$10
$5
$0
1973
1976
1979
1982
Drug Sales
Gambling
Prostitution


Crimes of Theft
Net Unreported Illegal Income
Billions of Dollars
$11
$10
$9
$8
$7
$6
$5
$4
$3
$2
$1
$0
1973
1976
1979
1982
Victim Type
Household
Retail
Transport
Other


White Collar Crimes
Illegal Income
Billions of Dollars
$6
$5
$4
$3
$2
$1
$0
1973
1976
1979
1982
Private
Welfare
Health Care

Appendix A

# Estimates of the Extent of Illegal Income from Medicaid and Medicare Fraud

From
Unreported Taxable Income from Selected Illegal Activities
September, 1984

Kenneth E. Carlson

Prepared for the Internal Revenue Service by Abt Associates Inc. under Contract Number TIR-81-57. Points of view or opinions stated in this report are those of the authors, and do not necessarily represent the official position or policies of the Internal Revenue Service.

## 10.5 Medicaid Fraud

All states except Arizona participate in the Medicaid program, which provides health services to eligible low-income people. The Federal government shares the cost of the program and sets minimum benefit levels. Each state determines its own eligibility criteria and may raise benefits above the Federal minimum.

Typically a physician, hospital, or nursing home submits bills directly to the Medicaid program, and payment goes directly to the provider. Fraud in the Medicaid program can occur in two forms: beneficiary fraud and provider fraud. Beneficiary fraud consists of the receipt of services by individuals who do not meet eligibility criteria. This activity is generally believed to occur primarily in the form of institutional care received by individuals who fail to disclose the existence of assets above the maximum allowed. The bulk of provider fraud consists of billing for services that were not in fact delivered. Such fraud is clearly illegal and falls within the scope of our study. However, it is important to distinguish between fraud and abuse. Abuse in this context consists primarily of billing for services that were actually provided but should not have been. Obviously, decisions as to the necessity and appropriateness of various procedures require expert medical judgment, so that the identification of abusive practices is often difficult. Moreover, in some cases, the dividing line between fraud and abuse may be somewhat blurred. For example, "upgrading," the practice of billing for service more extensive than that actually provided, is clearly fraudulent. Deliberate misdiagnosis leading to unnecessary diagnostic tests perfunctorily performed could be considered abuse, although it is fraudulent to the extent that no real services were delivered.

### Data Sources

In estimating illegal income from fraud in the Medicaid program we have relied on the first annual report produced by the Office of the Inspector General (OIG) of the Department of Health and Human Services. That report estimated the dollar amounts of losses due to fraud, waste, and abuse in fiscal 1977 for three broad categories of services: physicians, laboratories, and nursing homes. Subsequent OIG reports have not included estimates for

so detailed nor so comprehensive. We used the 1977 OIG estimates to extrapolate to other categories of services. We then extrapolated to our study years, using Health Care Financing Administration (HCFA) data on Medicaid expenditures by category of service.

We chose not to use the error rates compiled by the HCFA Bureau of Quality Control. Discussions with officials in the Bureau indicated that these error rates reflect primarily mistakes discovered during claims processing reviews and have little, if any, bearing on fraud. Indeed, the Medicaid error rates systematically exclude any cases known to be under investigation for fraud.

We should point out that the available information on Medicaid fraud is extremely scanty. First, the special OIG report was conducted for one year only, 1977. Second, the OIG report itself relies largely on secondary data about which little information on reliability is provided. Third, specific estimates of fraud and abuse were presented for only some components of the program. Finally, estimates for certain components combine fraud and abuse without indicating any breakdown between them.

Because of these problems, the resulting estimates should be regarded as highly tentative. Although we have attempted to indicate the uncertainty by making generous assumptions about errors, it might have been preferable to relegate Medicaid fraud to the category of an activity for which we could not find adequate information to make any estimate at all.

## Loss Estimates

### Beneficiary Fraud

As mentioned above, the primary mode of beneficiary fraud consists of failure to disclose assets above the allowable maximum. A study by GAO referenced in the OIG Study estimated the total benefits to such ineligibles at 1.2 billion dollars in fiscal 1977. However, GAO noted that a recipient with income above the allowable maximum would be entitled to benefits after "spending down" to the maximum. GAO estimated that about 50 percent of total benefits received would have been legitimate, had such spending down actually occurred. They therefore attributed only the other 50 percent of total benefits to fraud.

We will assume that in 1977, beneficiaries obtained 600 million dollars fraudulently. Based on total payments of 16.1 billion dollars in FY 77, this amount constitutes about 3.7 percent. We will use the 3.7 percent for each of the four years in our study, assuming a standard error equal to half of this rate, or 1.8 percent. Table 10.13 shows these results.

### Provider Fraud

We have defined provider fraud to mean billing for services not actually delivered. According to a report referred to in the OIG study prepared by the staff of a Special Senate Committee investigating such practices, billing for services not rendered is most commonly done by adding services not actually performed to an invoice with legitimate billings, or by submitting a totally fabricated bill for a patient the doctor has not seen or for an ailment not treated. The OIG report refers to "medicaid mills" which

pocket large amounts of money from unprovided and/or unnecessary services.

Medicaid is a complex program covering services by various types of providers. In the remainder of this section, we discuss the evidence on fraud for each type.

1. Individual Providers

The OIG report estimates that of $770 million in individual provider fraud and abuse combined, $220 million (28.6 percent) constituted fraud. Based on total payments to individual providers of $2,113 million, $220 million in fraud yields a fraud rate of approximately 10 percent. Moreover, in the absence of any other data with which to break down other types of fraud and abuse, we will apply the 28.6 percent to each of the other categories.

2. Nursing Homes

The OIG Report estimates $185 million in losses due to fraud and abuse out of $6,205 million in Medicaid payments to nursing homes in FY 1977. The report gives almost no indication of the precise nature of fraud beyond the general phenomenon of billing for services not provided. Applying the 28.6 percent rate based on individual provider behavior yields an estimate of 53 million dollars and a fraud rate of 0.9 percent.

Table 10.13

Medicaid Beneficiary Fraud

(millions of dollars)

| | FISCAL YEARS | | | |
|---|---|---|---|---|
| | 1973 | 1976 | 1979 | 1982 |
| 1. Total Program Benefits Payments | 8,640 | 14,135 | 20,474 | 31,918 |
| 2. Estimated Beneficiary Fraud Rate | 3.7% | 3.7% | 3.7% | 3.7% |
| standard error | 1.8% | 1.8% | 1.8% | 1.8% |
| 3. Estimated total beneficiary fraud | 320 | 523 | 758 | 1,181 |
| standard error | 160 | 261 | 379 | 590 |

Source: Office of Family Assistance, Department of Health and Human Services, telephone conversations.

Office of Inspector General, Department of Health and Human Services, 1977 Annual Report.

3. Hospitals

The OIG makes no estimate of losses to fraud in hospitals. Hospitals are more like nursing homes than any of the other categories for which the OIG made estimates. However, unlike nursing homes, a large proportion of hospitals are not for profit. To reflect this fact, we use a fraud rate of 0.6 percent rather than the nursing home rate of 0.9 percent.

4. Laboratories

The OIG report states that a total of $45 million is attributable to

fraud and abuse in laboratory services for Medicaid and Medicare combined. To break the estimate down into separate components for Medicaid and Medicare, we have assumed that fraud and abuse are roughly proportional to total laboratory payments in the two programs. Payments were $177 million and $64 million respectively in FY 1977. In percentage terms, Medicaid laboratory payments were 73 percent of the total laboratory payments for the two programs while Medicare laboratory payments were 27 percent. We therefore attribute 73 percent of the $45 million total to Medicaid, yielding an estimate of $33 million for laboratory fraud and abuse in Medicaid in 1977. Applying the 28.6 percent for fraud yields an estimate of $9.5 million in Medicaid laboratory fraud, and a fraud rate of 5.4 percent.

5. Other Services

We assume the fraud rate for other services lies somewhere between the extremes of hospitals (0.6 percent) and individual providers (10 percent), choosing an estimate of 5 percent.

Table 10.14 shows the OIG estimates and our estimated fraud rates for these five categories of service. We used these rates to estimate fraud losses in each category for our study years. Because we are extrapolating from data for only one year, our estimates should reflect considerable uncertainty. Lacking even qualitative information to guide us, we have conservatively chosen a standard error equal to 50 percent of our estimated rates.

Tables 10.15 through 10.19 display the calculations of losses due to provider fraud in each category. Because we do not have data on the breakdown of payments for 1982, we will apply the percentage breakdown [illegible]

Table 10.14

Medicaid Provider Fraud Rates Based on FY 1977 Data
(Amounts in millions of dollars)

| Type of Payment | Total Benefits | OIG-Based Fraud Estimates | Estimated Fraud Rate |
|---|---|---|---|
| Hospitals | 6,239 | n.a. | 0.6% |
| Nursing Homes | 6,205 | 53 | 0.9% |
| Physicians and Dentists | 2,113 | 220 | 10% |
| Laboratories | 177 | 9.5 | 5.4% |
| Other | 1,542 | n.a. | 5% |
| TOTAL | 16,277 | -- | -- |

Source: Office of Inspector General, U.S. Department of Health and Human Services, 1977 Annual Report, and calculations described in text.

Table 10.15

Estimated Medicaid Fraud: Hospitals

(Amounts in millions of dollars)

| | | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|---|
| 1. | Total Payments | 3,515 | 5,364 | 7,547 | 11,299 |
| 2. | Fraud Rate | 0.6% | 0.6% | 0.6% | 0.6% |
| | standard error | 0.3% | 0.3% | 0.3% | 0.3% |
| 3. | Total Fraud (line 1 x line 2) | 21 | 32 | 45 | 68 |
| | standard error | 10 | 16 | 23 | 34 |

Source for Total Payments: Health Care Financing Review, various issues.

Table 10.16

Estimated Medicaid Fraud: Nursing Homes

(Amounts in millions of dollars)

| | | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|---|
| 1. | Total Payments | 3,019 | 5,279 | 8,646 | 13,565 |
| 2. | Fraud Rate | 0.9% | 0.9% | 0.9% | 0.9% |
| | standard error | 0.5% | 0.5% | 0.5% | 0.5% |
| 3. | Total Fraud (line 1 x line 2) | 27 | 48 | 78 | 122 |
| | standard error | 14 | 24 | 39 | 61 |

Source for Total Payments: Health Care Financing Review, various issues.

Table 10.17

Estimated Medicaid Fraud: Physicians and Dentists

(Amounts in millions of dollars)

| | | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|---|
| 1. | Total Payments | 1,214 | 1,921 | 2,232 | 3,447 |
| 2. | Fraud Rate | 10% | 10% | 10% | 10% |
| | standard error | 5% | 5% | 5% | 5% |
| 3. | Total Fraud (line 1 x line 2) | 121 | 192 | 223 | 345 |
| | standard error | 61 | 96 | 112 | 173 |

Source for Total Payments: Health Care Financing Review, various issues.

Table 10.18

Estimated Medicaid Fraud: Laboratories

(Amounts in millions of dollars)

| | | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|---|
| 1. | Total Payments | 105 | 147 | 186 | 160 |
| 2. | Fraud Rate | 5.4% | 5.4% | 5.4% | 5.4% |
| | standard error | 2.7% | 2.7% | 2.7% | 2.7% |
| 3. | Total Fraud (line 1 x line 2) | 6 | 8 | 10 | 9 |
| | standard error | 3 | 4 | 5 | 5 |

Source for Total Payments: Health Care Financing Review, various issues.

Table 10.19

Estimated Medicaid Fraud: "Other"
(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Total Payments | 788 | 1,425 | 1,862 | 3,415 |
| 2. Fraud Rate | 5% | 5% | 5% | 5% |
| standard error | 2.5% | 2.5% | 2.5% | 0.5% |
| 3. Total Fraud (line 1 x line 2) | 39 | 71 | 93 | 171 |
| standard error | 20 | 36 | 47 | 86 |

Source for Total Payments: Health Care Financing Review, various issues.

the most recent year on which we have information, to the estimated total 1982 benefits of $31.9 billion. In light of the large standard errors assumed in applying fraud rates, the error in payment breakdowns will have a negligible effect. In Table 10.20, we summarize the estimates for the various components and present the total across components.

Income

Fraudulent benefits received by Medicaid beneficiaries comprise illegal income and are therefore taxable, even though Medicaid benefits are not taxed if legitimate. Therefore, we will regard the total amount of loss attributed to beneficiary fraud as illegal, untaxed income. Fraudulent payments received by providers are also taxable, but because they are received with the appearance of legitimacy, much of this income will be reported. We are concerned only with the unreported component of the fraudulent provider income.

In Table 10.21, we present our estimates of illegal undeclared income. In converting provider fraud estimates to undeclared income, we assume, on the basis of discussions with IRS staff, that 25 percent of the fraudulently obtained income will not be reported. This figure is frankly a rough guess and we will assume a standard error of 10 percent, implying a 95 percent confidence interval running from 5 percent to 45 percent.

Table 10.20

Total Estimated Medicaid Provider Fraud Loss

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Hospital Losses (Line 3, Table 10.15) | 21 | 32 | 45 | 68 |
| 2. Nursing Home Losses (Line 3, Table 10.16) | 27 | 48 | 78 | 122 |
| 3. Physician & Dentist Losses (Line 3, Table 10.17) | 121 | 192 | 223 | 345 |
| 4. Laboratory Losses (Line 3, Table 10.18) | 6 | 8 | 10 | 9 |
| 5. "Other" Losses (Line 3, Table 10.19) | 39 | 71 | 93 | 171 |
| 6. Total Losses (Sum of Lines 1 to 5) | 214 | 351 | 449 | 715 |
| standard error | 107 | 176 | 225 | 358 |

Table 10.21

Total Estimated Undeclared Income: Medicaid

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Beneficiary Fraud (line 3, Table 10.13) | 320 | 523 | 758 | 1,181 |
| standard error | 160 | 261 | 379 | 696 |
| 2. Provider Fraud (line 6, Table 10.20) | 214 | 351 | 449 | 715 |
| standard error | 107 | 176 | 225 | 358 |
| 3. Percent Unreported[a] | 25% | 25% | 25% | 25% |
| 4. Undeclared Provider Income (line 2 x line 3) | 53 | 88 | 113 | 179 |
| standard error | 27 | 44 | 57 | 90 |
| 5. Total Undeclared Income (line 1 + line 4) | 373 | 611 | 871 | 1,360 |
| standard error | 187 | 306 | 436 | 680 |

[a]Percentages supplied by the IRS.

## 10.6 Medicare Fraud

Since 1966, the Federal Medicare plan has provided health insurance for people aged 65 and over. The basic plan covers hospital insurance only. Supplementary medical insurance is available on a voluntary basis. The program has been expanding rapidly over the past 17 years.

We have estimated losses for provider fraud only, since we found no sources for estimating the extent of beneficiary fraud. This lack of attention to beneficiary fraud seems to reflect in part the relatively straightforward nature of eligibility for Medicare. While eligibility determination for other government programs is often complex, Medicare eligibility is based primarily on the simple fact of age.

### Data Sources

In estimating illegal income from provider fraud in the Medicare program we have relied on the same source we used for our estimates of Medicaid fraud: the first annual report of the Office of the Inspector General (OIG) of the Department of Health and Human Services. That report contained estimates of losses due to fraud, waste, and abuse in government programs in fiscal 1977. Subsequent reports have not included estimates nearly so detailed nor so comprehensive. We used the 1977 estimates to extrapolate to our study years, based on estimates of Medicare expenditures provided by the Health Care Financing Administration (HCFA).

As in the case of Medicaid, we chose not to use the Medicare error rates compiled by the Health Care Financing Administration. Discussions with HCFA officials indicated that these error rates reflect primarily mistakes discovered during claims processing reviews and have little, if any, bearing on fraud.

### Loss Estimates

As we mentioned in regard to Medicaid, fraud is illegal, whereas abuse is an ambiguous category. Since only fraudulent income can unequivocally be considered illegal, we have tried to estimate only fraudulent income and not income from abuse.

#### 1. Individual Providers

Because the OIG report makes no estimate of Medicare fraud by individual providers, we used the 10 percent fraud rate derived in the Medicaid section. Table 10.22 shows our estimates of individual provider fraud in Medicare, derived by applying the 10 percent fraud rate to HCFA estimates of total payments in this category for our study years. Because no breakdown of payments by type of service is available for 1982, we have applied the 1981 percentage to estimated 1982 total payments. Lacking any information with which to estimate a standard error, we have used a conservative guess equal to 50 percent of the estimated fraud rate here and in the following sections.

#### 2. Nursing Homes

The OIG report attributes $15 million to Medicare fraud and abuse

in FY 1977. As in the case of Medicaid, we have taken 28.6 percent of the entire amount as our estimate for fraud alone. Applied to FY 1977 expenditures of $357 million, this figure yields a fraud rate of 1.1 percent. Table 10.23 shows our estimates of nursing home fraud for the study years.

3. Hospitals

As mentioned in the section on Medicaid, the OIG report makes no estimate of fraud losses in hospitals. Hospitals are more like nursing homes than like any other category of provider; however, unlike nursing homes, many hospitals are non-profit. We therefore use a lower fraud rate of 0.8 percent. Table 10.24 shows our estimates of hospital fraud for the study years.

4. Laboratories

The OIG report attributes a total of $45 million to fraud and abuse in laboratory services for Medicaid and Medicare combined. Allocating this total according to the total laboratory payments in each program yields an estimate of $11.3 million for Medicare laboratory fraud and abuse in FY 1977. We assume that fraud constitutes the same proportion of this total as it does for individual providers in Medicaid (28.6 percent). Applying this proportion yields an estimate of $3.2 million in Medicare laboratory fraud for FY 1977. Combining this figure with FY 1977 expenditures yields a fraud rate of 5 percent. Table 10.25 shows our estimates of laboratory fraud for the study years.

Table 10.22

Estimated Medicare Fraud: Individual Providers

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Total Payments | 2,092 | 3,810 | 6,422 | 10,862[a] |
| 2. Fraud Rate | 10% | 10% | 10% | 10% |
| standard error | 5% | 5% | 5% | 5% |
| 3. Total Fraud (line 1 x line 2) | 209 | 381 | 642 | 1,086 |
| standard error | 105 | 191 | 321 | 543 |

Source for Total Payments: Division of Medicare Cost Estimates

[a]Estimate.

Table 10.23

Estimated Medicare Fraud: Nursing Homes

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Total Payments | 197 | 338 | 372 | 491[a] |
| 2. Fraud Rate | 1.1% | 1.1% | 1.1% | 1.1% |
| standard error | 0.6% | 0.6% | 0.6% | 0.6% |
| 3. Total Fraud (line 1 x line 2) | 2 | 4 | 4 | 5 |
| standard error | 1 | 2 | 2 | 3 |

Source for Total Payments: Division of Medicare Cost Estimates

[a]Estimate.

Table 10.24

Estimated Medicare Fraud: Hospitals

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Total Payments | 7,184 | 13,855 | 21,761 | 36,517[a] |
| 2. Fraud Rate | 0.8% | 0.8% | 0.8% | 0.8% |
| standard error | 0.4% | 0.4% | 0.4% | 0.4% |
| 3. Total Fraud (line 1 x line 2) | 57 | 111 | 174 | 292 |
| standard error | 28 | 56 | 87 | 146 |

Source for Total Payments: Division of Medicare Cost Estimates

[a]Estimate.

Table 10.25

Estimated Medicare Fraud: Laboratories

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Total Payments | 20 | 51 | 97 | 147[a] |
| 2. Fraud Rate | 5% | 5% | 5% | 5% |
| standard error | 2.5% | 2.5% | 2.5% | 2.5% |
| 3. Total Fraud (line 1 x line 2) | 1 | 3 | 5 | 7 |
| standard error | 1 | 2 | 3 | 4 |

Source for Total Payments: Division of Medicare Cost Estimates

[a]Estimate.

5. Home Health Agencies

For home health agencies we assume a fraud rate of 7 percent, lying between the extremes of individual providers (10 percent) and hospitals (2 percent). Table 10.26 shows our estimates of fraud losses in this category.

Income Estimates

Fraudulent payments received by providers are taxable, illegal income. However, because it is received under the appearance of legitimacy, much of this income will be reported. We are concerned only with the unreported portion of the fraudulent income.

In Table 10.27 we present our estimates of illegal, unreported income from Medicare provider fraud. In converting loss estimates to income estimates, we assume, as for Medicaid, a reporting rate of 25 percent.

Table 10.26

Estimated Medicare Fraud: Home Health Agencies

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Total Payments | 90 | 366 | 661 | 1,130[a] |
| 2. Fraud Rate | 7% | 7% | 7% | 7% |
| standard error | 3.5% | 3.5% | 3.5% | 3.5% |
| 3. Total Fraud (line 1 x line 2) | 6 | 26 | 46 | 79 |
| standard error | 3 | 13 | 23 | 40 |

Source for Total Payments: Division of Medicare Cost Estimates

[a] Estimate.

Table 10.27

Total Estimated Medicare Provider Fraud Loss/Income

(Amounts in millions of dollars)

| | 1973 | 1976 | 1979 | 1982 |
|---|---|---|---|---|
| 1. Individual Provider Losses (line 3, Table 10.22) | 209 | 381 | 642 | 1,086 |
| 2. Nursing Home Losses (line 3, Table 10.23) | 2 | 4 | 4 | 5 |
| 3. Hospital Losses (line 3, Table 10.24) | 57 | 111 | 174 | 292 |
| 4. Laboratory Losses (line 3, Table 10.25) | 1 | 3 | 5 | 7 |
| 5. Home Health Agency Losses (line 3, Table 10.26) | 6 | 26 | 46 | 79 |
| 6. Total Losses (sum of lines 1-5) | 275 | 525 | 871 | 1,469 |
| standard error | 138 | 263 | 436 | 735 |
| 7. Percent Unreported | 25% | 25% | 25% | 25% |
| 8. Total Unreported Income | 69 | 131 | 218 | 368 |
| standard error | 35 | 66 | 109 | 184 |